IRS ART ADVISORY PANEL

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

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IRS ART ADVISORY PANEL

TUESDAY, JUNE 3, 1986

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to call, at 9:30 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

Chairman PICKLE. I will ask the subcommittee to please come to order. I ask our guests to take their seats.

Today the Subcommittee on Oversight will focus on the work of the Internal Revenue Service's Art Advisory Panel. Members of the Commissioner's Art Advisory Panel review taxpayer valuations of artwork for Federal income, estate, and gift tax purposes. The Panel members make recommendations, based on their expertise, on the appropriate value to be assigned to the artwork on taxpayer returns. After review by the IRS' Art Valuation Section, the Panel's recommendations become the position of the IRS.

As testimony we receive today will reveal, a large number of taxpayers claim grossly inflated deductions for donations of artwork made to charitable institutions. In the alternate, a significant number of taxpayers claim artificially low valuations of artwork in calculating their estate or gift tax liabilities. Because of this over- and under-valuation compliance problem, the IRS created the Valuation Section and the Art Advisory Panel. According to IRS, since the art valuation area remains an area particularly susceptible to abuse, the service of the Panel is critical for effective administration of Federal tax laws.

The Art Advisory Panel's work is illustrative of one aspect of our current tax gap and compliance problem. Our review of the Panel's efforts will also highlight the complex nature of certain types of IRS examination issues and IRS' efforts to deal with artwork in the context of abusive tax shelters. It is my hope that today's hearing will not only expose what many taxpayers are doing, but also inform the public that the IRS and the Congress are active in this area.

I think you will find the high level of adjustments the Panel recommends on valuations of art objects to be indicative of a serious compliance problem we need to better understand. For example, in 1985, the Panel recommended adjustments of approximately $18 million on charitable deductions of $50 million claimed by taxpayers for donated artwork. In fact, one donated painting reviewed by the Panel in 1985 was overvalued by 95,900 percent. Also, we do

not know exactly what portion of all incorrect art valuations the Panel and art section actually see. Only selected returns are sent to the national office for review by the field. While I hope they are seeing the worst, I must question whether we have a good overall grip on the valuation situation.

During our review, we will discuss the expected impact of recently enacted over- and under-valuation penalties and appraisal and reporting requirements. This will put the subcommittee in a position to decide what additional steps or action should be taken—either administratively or legislatively.

I look forward to each witness' testimony. We all appreciate the special efforts the witnesses on our two Panels have made to join us today and share their expertise with this subcommittee.

I will ask Mr. Schulze if he has any opening statement to make. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

Mr. Chairman, I commend you for calling what I believe will prove to be an exceptionally interesting hearing. The Internal Revenue Service is to be commended for the work of the Art Advisory Panel. The Panel is an excellent example of the partnership which can exist between Government and private business.

It is my understanding the operating costs of the Panel are only about $15,000 a year due largely to the fact Panel members serve without pay. The benefits provided by the Panel are considerable in relation to the meager costs expended, even without considering the general in terrorum benefits which the Panel provides.

I look forward to today's hearing, the witnesses, and to the testimony and the dialog. Thank you, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Schulze.

Our first Panel will be testimony by the Internal Revenue Service. James Owens, Acting Commissioner, accompanied by Karen Carolan, Art Valuation Section. You have another gentleman with you. Will you identify the other gentleman with you, Mr. Owens? We will be pleased to hear your testimony.

STATEMENT OF HON. JAMES I. OWENS, ACTING COMMISSIONER, INTERNAL REVENUE SERVICE, ACCOMPANIED BY KAREN CAROLAN, CHIEF, ART VALUATION SECTION; AND FREDERIC P. WILLIAMS, ASSISTANT COMMISSIONER FOR EXAMINATION

[The prepared statement begins at p. 140.]

Mr. OWENS. Thank you very much, Mr. Chairman.

Let me say at the outset we appreciate the opportunity to discuss this important issue with the committee. It is but one aspect of tax administration, but we think a very important aspect of it.

With me today, as you have already introduced, is Karen Carolan, who is the Chief of the Valuation Section in the Appeals Division; and on my right is Fred Williams, our Assistant Commissioner for Examination.

In my testimony today I will discuss the problems of overvaluation and undervaluation of artwork, the background of the Art Advisory Panel, the work of the IRS Art Valuation Section, and current law penalty provisions.

Questions of appropriate valuation of artwork can have a variety of tax ramifications. For example, valuation is essential in determining the appropriate dollar amount of charitable contributions for donations of artwork, the determination of the tax base for estate and gift taxes, and the determination of the benefits associated with property eligible for depreciation or the investment tax credit. As a result, the problem of valuation can be either overvaluation—for example, for charitable contribution purposes—or undervaluation—for example, for estate or gift tax purposes.

Valuation issues arise throughout the Internal Revenue Code. Because valuation problems are so dependent upon the facts and circumstances of each individual case, these issues are among the most difficult facing the tax administrator. In addition, the normal problems associated with valuation of property are further complicated in the context of valuing art. As the committee will see from a brief slide presentation that will accompany my testimony, the components of value in artwork are frequently more subtle, volatile, and complex than the components of value in more conventional tax contexts, such as the valuation of an office building or depreciable property. Consequently, the Service is dependent upon its own art experts and the assistance of outside consultants, such as those represented on the Art Advisory Panel.

The Commissioner's Art Advisory Panel was established in 1968 to address problems arising with respect to the valuation of art. At that time, there was an increasing recognition by both the Internal Revenue Service and professionals in the art world that valuation issues were becoming a growing area of taxpayer noncompliance. A cooperative effort involving the IRS, the Art Dealers Association of America and museum officials led to the development of a system to monitor appraisals of artwork through the establishment of the Commissioner's Art Advisory Panel. The Panel assists the Internal Revenue Service by reviewing and evaluating the acceptability of property appraisals submitted by taxpayers in support of the fair market value claimed on works of art involved in Federal income, estate, or gift taxes.

Currently the Panel may include up to 25 members drawn from various segments of the art world. To ensure representation of both sellers' and buyers' perspectives regarding art trends and values, the Panel composition is diverse, with 8 to 10 art dealers and 15 to 17 museum directors, curators, and scholars. Specialists in each of the major schools and periods of art are selected and specialists in a particular field of art are selected as needed. Panelists are subject to review and reappointment annually. All Panelists are processed as special Government employees and must submit the required financial disclosure statements for review and approval by the Ethics Committee of the Department of Treasury. Panel members are bound by the laws prohibiting disclosure of information from tax returns. Panelists serve without pay; however, reimbursement for travel and lodging expenses in connection with Panel meetings is provided.

When originally formed, the Art Advisory Panel focused primarily on painting and sculpture. In 1984, the Panel was expanded to add expertise in, one, pre-Columbian and primitive art; and, two, Far Eastern and Asian art. These two new groups were added be-

cause the Service found that overvaluation of these types of art was becoming more common and special expertise was needed in these areas. Currently, the Panel membership is divided among a painting and sculpture group and these two post-1984 groups. The most recent Panel meeting was held on May 22 to review Far Eastern and Asian art.

A work of art may come before the Panel in several ways. Under the Panel's original rules, any audited return containing an appraisal of a single work of art with a claimed value of $20,000 or more was referred to the national office for review. This referral authority has been expanded to cover audited returns containing an appraisal of any collection of artwork valued at $20,000 or more. In addition, IRS field examiners are encouraged to request valuation assistance on works of art at any time they encounter valuation problems.

Panelists are provided with photographs and other materials regarding the artwork to be reviewed in advance of meetings. Panelists frequently conduct their own research as well. At the meeting, Panel members express their opinions as to the acceptability of the claimed valuation. As a general rule, the Panel members are able to reach a consensus on value very quickly. In the relatively rare instances in which a consensus is not reached, the Panelists will obtain additional information either personally or through the efforts of the IRS staff.

During the years 1977 through 1985, the Art Advisory Panel reviewed 1,565 taxpayer cases involving 6,717 items of art. The Panel recommended an adjustment of valuation for approximately one-half of the items reviewed. The total claimed value of these items was $525 million, and the Panel recommended adjustments of $115 million.

Since the expansion of the Panel in 1984 to include expertise in primitive/pre-Columbian and Far Eastern/Asian art and the expansion of the screening criteria to include collections of art valued at $20,000 or more, the Panel is reviewing an increasing number of items. Perhaps as a result of the increased review of lower valued items during 1984, and 1985, the percent of items for which the Panel recommends a change in value is rising. For example, since 1984, adjustments were recommended on 73.5 percent of items reviewed. An additional 5.5 percent required further development for determinations of value.

Although the Art Panel was initiated in 1968 and was principally involved in reviewing valuations of original works of painting and sculpture, much of the Panel's notoriety came from its reviews of art prints. During the late 1970's and early 1980's, certain tax shelter schemes utilizing art prints became very popular. The key to these schemes was the gross overvaluation of property followed by the use of investment tax credit and depreciation by the taxpayer.

In response to these abusive schemes, the Art Print Advisory Panel was formed. From its establishment in November 1980 through 1983, the Art Print Panel reviewed 1,650 items. Total taxpayer claimed value for these items was $219,758,000, and the Panel recommended adjustments totaling $216,881,000—a 98.6-percent reduction from the value claimed on the returns. Eight of the

art print tax shelter cases were litigated, and an Art Print Advisory Panelist testified as an expert witness in seven of these cases. The Service prevailed in six cases, and two cases are still awaiting decision.

The Art Print Advisory Panel was a successful effort which has contributed to the virtual elimination of the abusive art print tax shelter schemes it was established to combat. Due to a lack of cases, the charter for the Art Print Advisory Panel was allowed to expire in March of 1985. In fact, if there was a need to reestablish that at some later time, we would feel free to do that.

In addition to the Panel, the national office has an Art Valuation Section which is available to provide assistance to field examiners and the Appeals Division, as well as to provide support services for the Art Advisory Panel. The Service's art valuation staff is composed of five full-time appraisers with backgrounds in art history. They coordinate Panel activities, research, and prepare materials for Panelists to review in connection with valuations and also review appraisals of artworks which are not referred to the Panel.

After Panel meetings, the national office art appraisers prepare valuation reports on the rejected appraisals. These reports are returned to the district office which initiated the referral to the Panel. The taxpayer is notified of the Panel decision and provided with a copy of the report and a list of the Panelists.

At this point in my statement, I would like to introduce Karen Carolan, Chief, Valuation Section. Ms. Carolan is an expert in art valuation issues and is the senior IRS official with operational responsibility for the Art Advisory Panel. Ideally, her presentation might show actual works of art that came before the Panel along with the taxpayer and Service valuations. However, the confidentiality provisions of section 6103 of the code prohibit the use of live examples. Instead Ms. Carolan will use this opportunity to provide the subcommittee with examples of the kinds of issues that come before the Panel. These examples are either from public sale information or relate to cases that are public information.

So at this time I would introduce Ms. Carolan.

Chairman PICKLE. Would you suspend just a minute?

Do you want to put a value on it first?

Ms. CAROLAN. No. In valuing in art, like valuing in any kind of property, is so important first to know what you are valuing. Here we have two Picasso paintings, and what is important here is even with a famous artist, like Pablo Picasso, all Picasso paintings aren't valued equally. In these slides we have portraits of men; the self-portrait Picasso, which is a rare Picasso from 1901, sold for $5.3 million; yet the Picasso on the left, which is a later, less desirable period, sold for $275,000. So much in valuing art, as in any type of property, is rarity, and there really are certain rules that govern the valuing of each object.

Now these two slides are both of Renoir paintings. They are similar in composition, landscapes with a figure, yet the one on the right sold for over $2 million. It is an early 1876 work, and it is very early and beautiful in quality, with a large figure and it is exquisite. However, the one on the left sold for only $42,000. Again, it is a later sketch work and is not as important as the one on the right. But, again, it is so important to know what is comparable

and what is not comparable, and that is what we try to do in placing a value by the Art Advisory Panel.

Even with geometric abstractions, such as these squares, there are differences in value. On the left, we have an Albers painting. Now Albers generally always painted squares. Most of his life was devoted to a series "Homage to the Square." Consequently, with Albers, in general, his prices are quite level, and are based on certain criteria that come into play: how many squares are within a square, the colors, and the size. This one sold for $18,000 in 1984.

On the right we have a Frank Stella work. It is from his scramble series. Stella is a contemporary American artist who works in series. This work is not really one of his most particularly desirable series, sold for $92,250.

Probably one of the most famous artists in this type of mode is Rothko, on the left is a 1958 work, 102 by 169 inches, that sold for $1.8 million. Being from Washington, I know if you have ever gone to the Phillips Gallery, you have seen their whole room of Rothko works. Rothko, who is no longer living, is a rare artist, a desirable artist, a major contributor to abstraction expressionism. His colorful paintings are very expensive.

The Mondrian on the left, a composition in red, blue, and yellow, sold for $2.3 million. It is only 20 by 20 inches. Mondrian's work's, particularly those that are in very good condition, because a lot of them have condition problems, are highly esteemed. When this was sold in 1984, it was not only the record price for the artist, but for any abstract work of art.

Now, sometimes people just don't understand modern art. Here on the left, while it perhaps looks like scribble to some, is a Twombly work, oil and pencil, that sold for $418,000 last fall at Sotheby's.

On the right, what might look like finger painting to some is a rare work that sold for $1.5 million entitled "Ruth's Zowie," a 1957 work by William de Kooning. Another de Kooning sold for $1.9 million, and that was a record price at auction for a work by any living American artist at that time. Again, so much depends on determining the quality of the work. While modern art might not appeal to many, there really are definite factors that make it rare and valuable.

While some artists are expensive in certain mediums, like sculpture rather than painting, or vice versa, Remingtons are generally quite expensive in both. Here we have two typical western subjects, which he normally did; the "Bronco Buster" painting on the left sold for $473,000, and a very rare sculpture by Remington "The Norther," which sold for $715,000, on the right.

But, again, so many factors affect that high value. It is a very rare sculpture, and before it was sold at auction, only one other cast was known. This is unusual in sculpture, for many times they are in series or editions. It was also the first time he tried a new type of medium, the lost-wax process, in which he could get this deep undercutting and texture in the bronze, which before he couldn't get with the sand-casting technique.

Chairman PICKLE. On both of those Remingtons, are both of those——

Ms. CAROLAN. Yes, they are, sir. Western painters, in general, are quite sellable—Remingtons, Russells, and so forth.

Now, in the Far Eastern area, here we have two Ming blue and white dishes. They were sold at the same sale, they are similar in period and type, as you can see, and yet the one on the right sold for three times the price of the one on the left. That is because of a subtle difference in the glaze which is termed "heaped and pile." The right example has a much finer glaze, and particularly in ceramics, these subtle quality differences can really affect the value. As you can see, the glaze of cobalt blue is thicker, darker, and much finer than the one on the right.

Again, we have two pieces that seem so similar but have subtle differences. These are both Northern Song Henan brown jars; yet the one on the right, besides having a finer glaze, is also from a famous collection. It has a distinguished provenance, and that enhances its value and increases its price.

Now, here we have a jade water buffalo on the right. It is a Ming piece, from the 15th century. It is very important to determine the authenticity of the piece. Jade is one of those problem materials that oftentimes is not authentic. Some of the objects we review are not jade, but are a softer material, serpentine in many cases. If you notice this piece, where it is carved it doesn't turn white, it is the same green jade color. Many times in the softer materials, when you cut into them they turn white. So, again, it is important for us, before we put a value on it, to determine if it is really authentic jade.

But here we have two pieces. On the right, we have the Ming, 15th century, water buffalo and on the left a 7th to 10th century hare. Being older or bigger in size doesn't necessarily make it more valuable. The jade water buffalo on the right sold for over $130,000, where the older hare on the left, $100,000.

Probably one of the more clear and wonderful examples are these two Tang horses. The one on the left sold for $38,000; yet the one on the right sold for $660,000. It is clearly more exquisite—if you just look at the stance of the horse, the quality of the glaze is beautiful; also it is in perfect condition. In addition to this, which you probably can't see from the slides, unlike the left one, which is on a plain base, the one on the right is on a carpet. The base is painted like an oriental carpet because these pieces were used as furniture objects. This horse was made for an imperial tomb, and this also increases its value. It was also in perfect condition, and in ceramics that can really affect the value.

Here we have two Ming chicken cups from the 15th century. The one on the right is only one cup, but it is four views of the one cup. If you look at the lower right area, that is the same view as the one on the left. The chicken cup on the right sold for over $1 million, yet the one on the left, which again is similar in type and size, and these are very small, sold for only $22,000. But the one on the left is chipped and cracked, and in many things conditions can really affect value.

We have talked about authenticity, and in African art, as in certain other areas of art such as jade and ivory pieces, old master paintings, and so forth, authenticity comes into play. In African and pre-Columbian art in particular, it is very important to really

determine if we have a traditional African art piece—and traditional African art can sell at up to million-dollar figures—or if we have tourist African art. Tourist African art, which can sell for a couple hundred dollars to maybe a thousand, wasn't made for traditional purposes, but for the trade.

Now, the next pieces were all involved in our first trial involving African art. The trial was before the expansion of the Panel to the primitive area. One of the Panelists, who is now on that Panel, testified for us as our expert witness. The important question in this case was whether these pieces were authentic African art pieces or tourist pieces. And on many objects, it was authenticity that was disputed by the IRS.

Several of the pieces that you will see now will show the disparity in values between what the taxpayer valued the piece at and what IRS did. I would like to say at this point that the taxpayer had valued the entire collection at $1.5 million. The IRS had valued it at $167,000, and the court decided entirely for the Internal Revenue Service.

Here we have what is supposed to be a Dogon monkey mask. Dogon monkey masks are traditionally made out of light wood. Sometimes they are painted white, but are generally of light wood. You can see front and the back views. You can see how it is peeling. It is made out of dark wood. Originally the taxpayer thought it had a very subtle and fragile patina, but what it was found to be was farina. This was valued by the taxpayer at $500,000. The IRS valued it at $275, and the court agreed with our value.

Here we have two Luba Kifwebe masks. The one on the left is the piece that was in the trial. The one on the right is an authentic piece and what a Luba mask is supposed to look like. As you can see, the one on the left is a small wooden bowl that was covered with leather and bead strings to try to simulate the striations of the authentic one on the right. This was valued by the taxpayer at $15,000. We valued it at $100, and our valuation was upheld by the court.

A Guerse fetish figure valued at $9,500 by the taxpayer is next. In reviewing this piece, our experts said that not only was this a tourist piece, but also it did not resemble any traditional African art piece—it was a figment of the artist's imagination. We valued it as a decorative piece at $550.

This next item is a Songe figure, a very large figure at 32 inches. It was valued by the taxpayer at $40,000. It was valued by our expert as a large decorative tourist object, at $850.

And here we have two Mende helmet masks. This is one helmet mask but two views. This is an authentic piece, but it is very poor quality; you can see all the erosion and the cuts in the surface. It was valued at $5,000 by the taxpayer. We valued it at $500.

The next item is supposed to be a Baule sorcerer's fetish. This piece might be real, but it is very difficult to determine. It was valued at $5,500 by the taxpayer, and at $200 by IRS.

Here we have some Kpelie masks. The ones on the right are authentic. The ones on the left are not. It is difficult to see, but the masks on the left are stylistically wrong. They are of black wood and have no evidence of usage. However, you need to be an expert

to determine if it is authentic or not, but the ones on the left were determined not to be.

When we talk about tourist pieces, they are often mass produced for the trade, and this slide shows the mass producing of these types of masks.

Now, while the Art Advisory Panel reviews paintings and sculpture, African/pre-Columbian and Far Eastern/Asian art, our office reviews all different kinds of property as well, such as historical property, furniture, carpets, and decorative pieces. It is very important for our staff appraisers—and our appraisers to travel and view the property, particularly in the African and pre-Columbian area—to photograph the items and to make sure that things are as they are claimed to be.

This is an example where travel and examining the work for its condition was quite revealing. This was a case that went to trial on a 1952 Short Sealand plane. When the appraiser went out to view it, this was the condition it was found to be in. As you can see, it is not really in the best shape. It has no wings, it was just on blocks behind the museum in the field. It would have cost $200,000 to be made flyable. The taxpayer claimed $90,000 for this piece. We valued it at $18,000. For only $30,000, you can get a perfectly good flyable plane, as you see in the slide on the right. Our office helped secure an expert to testify for the IRS; the court decided in favor of the IRS.

This presentation has been made to give you some examples of what we do. Thank you.

Mr. OWENS. Thank you very much.

Chairman PICKLE. Will Ms. Carolan also stay at the table?

Mr. OWENS. Yes, she will be available, as well as other people here, Mr. Chairman.

With this background, let me turn to some statistics which I think will be of interest in some areas of difficulty the Panel has. Consistent with the rules of section 170 of the code, charitable contributions are allowed as a deduction on Federal income tax returns. In tax year 1983, 32 million taxpayers claimed total charitable contributions of $37.7 billion; 7.8 million of these taxpayers made noncash contributions of $5.8 billion. For 1983, the total reduction in tax liability resulting from charitable contributions is estimated to be approximately $13 billion. The IRS does not maintain statistics that would permit an analysis of the amount of these noncash charitable deductions attributable to contributions of art.

As this committee knows, every 3 years, the IRS completes its comprehensive study of filed individual income tax returns. This study is known as TCMP, or the Taxpayer Compliance Measurement Program. The most recent TCMP data provides valuable insight into the question of taxpayer compliance levels in the charitable contribution area. In particular, the TCMP study showed that about 20 percent of taxpayers overstated their charitable contributions, and 7 percent understated them. Compliance with respect to contributions of property was measurably lower than contributions of cash. In the area of noncash contributions, even though one-third fewer taxpayers made errors, the size of their errors was about one-third greater.

For charitable contributions made after December 31, 1984, the Service will now have available for review "qualified appraisals" submitted with the tax return on which a deduction for donated artwork was claimed. The Tax Reform Act of 1984 directed the Service to prescribe regulations requiring individuals and certain other taxpayers to obtain qualified appraisals for contributions of artwork and other property whose claimed value exceeds $5,000.

In addition to these regulations, the Service issued form 8283 which a taxpayer must file when claiming the deduction. Form 8283 requires a description of the donated property, a listing of its fair market value and cost to the donor, an acknowledgment of receipt of the property by the donee, and a certification by the appraiser that he or she is a qualified appraiser. A "qualified appraiser" must be qualified to make appraisals of the type of property donated. Further, the appraiser cannot be the taxpayer, the recipient, a party to the transaction in which the taxpayer acquired the property or any person whose relationship to the taxpayer would cause a reasonable person to question the appraiser's independence.

The appraisal itself must be made within 60 days prior to the date of contribution and must include the specific basis of the valuation, a statement that the appraisal was prepared for income tax purposes, the appraiser's qualifications and the signature and taxpayer identification number of the appraiser.

Form 8283 also requires that the recipient acknowledge that it is an organization qualified to receive charitable contributions under IRC section 170(c) and affirm that in the event it sells, exchanges or otherwise disposes of the property within 2 years, it will file an information return with the IRS on form 8282. This information return must describe the donated property and provide the date of contribution, the date of sale, exchange or trade of the donated property and the amount received for the property. The Service believes that these new requirements will be extremely helpful in reviewing claimed valuations of donated artwork. Copies of the forms are attached to my statement.

With respect to art valuation problems, a wide range of IRC penalty provisions may apply. Some of the provisions are specific to the problems of overvaluation or undervaluation, but others are generic in nature. Without intending to provide an exhaustive overview of the potential penalty provisions, it would be appropriate to highlight some recent changes that have general application to art valuation problems.

The section 6659 penalty provides for an addition to tax for certain underpayments attributable to a valuation overstatement. The penalty is generally based on a sliding scale, becoming more severe with the severity of the overvaluation. Section 6659(f) provides special and generally more stringent rules for charitable contributions. If a taxpayer's claimed value of a charitable contribution is 150 percent or more of the correct amount, an addition to tax of 30 percent of the underpayment may apply. This penalty may be waived if the taxpayer's value was based on a qualified appraisal by a qualified appraiser and the taxpayer made a good-faith investigation into the value of the property. This penalty was added in

1981 and the special charitable contribution rules were added to section 6659 in 1984.

A sliding scale penalty similar to that found in the valuation overstatement area is also present for valuation understatements. This penalty is applicable for purposes of estate and gift tax liabilities. This penalty was enacted in 1984.

During the 1970's and early 1980's, charitable contributions of artwork, and in particular art print schemes, were used as tax shelter mechanisms. Section 6700, the penalty for promoting abusive tax shelters, and section 6701, the penalty for aiding and abetting the understatements of tax, were used to combat this abusive shelter activity. These penalties were enacted in 1982.

Another change made in the 1984 act was the amendment of title 31 U.S.C. section 330 to give the Secretary of the Treasury the authority to bar from appearing before the IRS any appraiser against whom a section 6701—aiding and abetting penalty—has been assessed.

As I mentioned, these penalities are not exclusive. The fraud or negligence penalty under section 6653 may apply or the substantial understatement penalty under section 6661 may be applicable.

Since the IRS generally examines and returns a year or two after they are filed, we have only a few years experience with the 1981 and 1982 penalty changes and virtually no experience with the 1984 changes. Consequently, the Service currently has no legislative recommendations with respect to statutory changes.

The expanded scope of the Art Advisory Panel, combined with the array of penalty provisions and the new qualified appraisal and donee information forms now provide us with valuable tools to monitor compliance and combat abuse in this area. We recognize the need for continued vigilance, and we will continue to use the tools which Congress has made available to us in conjunction with the Art Advisory Panel in order to fulfill our mission.

My colleagues and I are available to answer any questions you or the members may have.

Chairman PICKLE. Thank you, Mr. Owens.

Let me first ask, Ms. Carolan, whether the pictures and slides you showed are from actual cases.

Ms. CAROLAN. No; the first part was all public auction sales, primarily from Sotheby's or Christie's in New York. These sales are advertised beforehand with published catalogues and are open to the public and published. The last group was from trials that have already been decided and that the Art Valuation Section had been involved in.

Chairman PICKLE. As your Panel reviews these objects, I assume you can do so by photographs that have been sent to you by the regional office or from whatever source you request. Can you make a valuation of a piece of art based on a photograph?

Ms. CAROLAN. Well, generally photographs are limited, but are our administrative necessity. We are requiring taxpayers to provide better and better photographs, so we can make some initial type of judgment. If there is ever a question, though, on condition or authenticity or whatever, we will go back and get more information or better photos, or have a Panelist go and visit the pieces. That is in the painting and sculpture area.

In the pre-Columbian era, generally we do not really accept photographs that the taxpayers send in. We send someone out to examine the objects. The person who handles those cases will go out and photograph them from five or six different views, because in those areas authenticity is often the problem. Also with the Far Eastern and Asian area, again we have supplemental photographs.

Chairman PICKLE. If a person claims a value of $25,000 on a painting and you have a photograph of it and your Panel is to make a valuation of it also, do you often go to the museum where it has been donated to see the artwork itself? Do you send people to that source, or do they come before your Panel? Also, does your Panel meet once or twice a year?

Ms. CAROLAN. Twice a year. No; they cannot come before the Panel because the Panel meetings are closed to the public. On a number of occasions, appraisers do travel and view the property.

Chairman PICKLE. The Panel or someone representing them?

Ms. CAROLAN. Someone either from our office, or if there is an authenticity problem or question, we will have a member or members of the Panel actually go and examine the artwork. But it is impossible to have them all sent to our office.

Chairman PICKLE. Mr. Owens, we do not have enough history of the penalties at this point to know whether the penalty provisions are too severe or not severe enough. I presume we have no recommendations from you?

Mr. OWENS. That is correct, Mr. Chairman. We just don't have enough experience, particularly with the 1984 changes—which took effect December 31, 1984—which provides for the additional information to be submitted. We think that will be very, very helpful for that form to be filled out any time there is a value put on an item over $5,000.

May I just add one other thing? I think in about 5 to maybe 10 percent, somewhere in that range, additional information is requested by the Panel. And that means one of two things: Either one of the people on the staff here goes out to get that information, or in certain circumstances the Panel member will go out.

Chairman PICKLE. You indicated in your testimony that the review usually would be 1 or 2 years, in retrospect. This is 1986, and you will be reviewing 1982 or 1983 reviews now, or in that neighborhood. What tax-year returns are the Panel currently reviewing?

Mr. OWENS. I believe the majority of them are 1983, and they are doing some 1984's. 1983 and 1984 would be the——

Chairman PICKLE. 1983 and 1984. Now, no cases are being reviewed yet for the year 1985 so far as you know?

Mr. OWENS. That is correct, I am rather confident they don't have any for 1985, Mr. Chairman.

Chairman PICKLE. What is the date of the oldest case under consideration that is being reviewed by the Panel?

Mr. OWENS. Somewhere in the mid-1970's we believe would be the oldest. That is rare we would have one that old.

Chairman PICKLE. But you do go back as far as that number of years if you think it is important?

Mr. OWENS. Yes; if for some reason the case has been kept open by the statute of limitations.

Chairman PICKLE. You are saying there is no statute of limitations involved in these reviews?

Mr. OWENS. There is. The statute of limitations probably would have been kept open.

Chairman PICKLE. What is the statute of limitation?

Mr. OWENS. Normally it is 3 years, but it depends on the amount of tax involved.

Chairman PICKLE. Do you go back beyond that on the basis if you suspect fraud, is that it?

Mr. OWENS. Yes, we do.

Chairman PICKLE. Do you, as an individual have any recommendation to us with respect to penalties? I understand you have to have some history, but if you are running 2 or 3 years behind, we may not have anything to base a recommendation to the Congress on if we were to make such a recommendation for another 2 or 3 years if you are going to be reviewing 2 or 3 years backward. So how is the Congress going to be kept abreast at this point whether this system is working? Can you give us any commentary on that?

Mr. OWENS. We believe the system is working in terms of the specific duties and responsibilities assigned to the Panel. With respect to the penalties, there are so many of those, and it is a complex set of penalties where sometimes one particular penalty kicks in only if another one applies. It is unfortunate, but we have had limited experience in the use of those.

I certainly believe as a tax administrator those penalties have an effect. What effect and what other changes ought to be made, I am not in a position to say. We are looking at the entire area, trying to do some more analysis during 1986 in terms of the charitable contributions and what part of that is really artwork, and out of that study, which will be available sometime toward the end of this year or the first part of 1987, will come further data.

Chairman PICKLE. I notice in your testimony you said you have one section of the Art Print Division and that you had instituted some penalties and emphasized research or investigation in that area and that a lot of abuses have now been corrected. Can you give me an example of what you call the print division, art print.

Mr. OWENS. Let me let her explain art prints.

Chairman PICKLE. What are you talking about?

Ms. CAROLAN. In the late 1970's and early 1980's, art print tax shelters were very popular in the print world.

Chairman PICKLE. What do you call art print?

Ms. CAROLAN. An art print is just an image on paper like a poster, or a reproduction. Prints are usually reproduced in multiples.

Chairman PICKLE. Lithographs?

Ms. CAROLAN. Lithographs, yes, and engravings, those things too are termed "prints." The total number of prints of one image is an edition. Images come in editions of 200 or 300.

What was happening, people were buying masters of a particular image and the right to produce a limited edition of that image. They also purchased any ancillary rights to the image to make tablecloths, napkins, et cetera. They were also taking depreciation on the prints. They would pay a certain amount of cash upfront for this whole package and take a nonrecourse note on the rest of it.

Chairman PICKLE. I didn't get the last part.

Ms. CAROLAN. Take a nonrecourse note on, say, three-fourths of it. They would then have an appraisal, like a six-figure appraisal for the whole investment package, and then they would take depreciation and investment tax credit on the master plate, saying that this was so valuable. So it was really a tax gimmick.

This was very very prevalent in the late 1970's, and that is when we established the Art Print Advisory Panel, to deal with this whole area of abuse. The Panel was in existence from 1980 to 1984. We reviewed a large number of those objects, and we did literally require taxpayers to send in one of the prints to our office, and the Panel really reviewed the prints. But it went out of fashion by 1984. Also, we had a number of trials, and the Service won on these trials. Because in most cases, or virtually all cases, they were not economically viable packages.

Chairman PICKLE. Are you saying that if an artist wanted to reproduce a painting, he has a photograph or an engraving made of that, then reprints so many number, a limited number? You say they were claiming investment tax credit?

Ms. CAROLAN. On the master.

Chairman PICKLE. On the master whether it is a photograph or engraving.

Ms. CAROLAN. Many times it was like a four-color separation or the mechanical——

Chairman PICKLE. Have you been able to stop that type of practice?

Ms. CAROLAN. Yes; and that is why the Print Panel charter was not renewed, because the inventory had dropped so dramatically across the country.

Mr. WILLIAMS. Mr. Chairman, I think this gimmick falls more in the area of an abusive tax shelter, which was being promoted in 1980, 1981, and 1982. Through the application of penalties and through examining those particular cases, that particular abusive shelter scheme has been put out of business, and we are not seeing that today. The promoters have moved on to other areas outside of that, Mr. Chairman.

Chairman PICKLE. Let's assume I have a print or two that had been given to me. No, I purchased both of them, correction, and they are a limited number of southwestern scenes, we will say. Do you put a value, then, on the reprint, that is print number 50 of that 300 issue?

Ms. CAROLAN. We will value the print that you have.

Chairman PICKLE. You still allow that?

Ms. CAROLAN. Yes; but the print shelters were not contributions at all. They were tax shelter schemes, you know, based on the value of the print packages. They weren't charitable contributions particularly.

Mr. WILLIAMS. They were taking, Mr. Chairman, the inflated value and claiming a 10-percent investment credit, and depreciation on that false inflated value, rather than taking it really in the contribution.

Chairman PICKLE. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

I would like to thank the Panel and especially Mr. Owens. As you know, Mr. Commissioner, I did attend the meeting of the board. I was very impressed with their efficiency and their knowledge. Mr. Owens, will you describe for me and for the subcommittee the process involved in determining whether the IRS should audit a taxpayer with large charitable deductions for artwork. Is there a threshold for an audit? Who determines whether an audit should be undertaken, and is an audit triggered by other things other than the art contribution?

Mr. OWENS. For the majority of the returns, Mr. Schulze, the examination process begins with the scoring of that return when it is processed, and the scoring is based on historical data that we have gathered over a number of years through the Taxpayer Compliance Measurement Program. Then each return, once it is processed into the master file, has a numeric score.

The higher the numeric score, the greater the probability there is a need to examine the return, because of either overstating deductions or understating income. There are many relations among and between the various line items on the returns that create that score.

In addition to that, there are times when those returns would be examined based upon a number of other things. If it came to our attention by someone who might provide an information item to us, or we received information through other investigations about artwork being sold exclusively in a certain area, and there was some question about the value, certainly we would look into those. If it came to our attention through the news media, as it has done from time to time on some occasions, we would go and look into those too. It does not mean that we would automatically examine those, but we would certainly look at the return and come to some judgment as to what that showed. Based on what we have seen historically, if it contained a large charitable deduction that was noncash, or if it was a piece of artwork, it would in all probability end up being examined, and we would look at the value of that artwork.

Mr. SCHULZE. In most instances of large art contributions, say over $20,000 or $25,000, I presume the charitable contributions would act as the triggering device, but on other returns it could be other items?

Mr. OWENS. That is correct. For any item on any return that is being examined, where there is $20,000 or more in the aggregate for some artwork, that is required to be sent into the Art Advisory Panel for review and evaluation. And then, in any piece of work that has been donated and a charitable deduction taken for that, the agent may send it in even though it is substantially less than that amount.

Mr. SCHULZE. Although the print shelter has been virtually eliminated, to what extent are charitable tax deductions used as a tax sheltering device?

Mr. OWENS. I am not sure I have any figures that would give you any information on that, Mr. Schulze. I don't know whether Mr. Williams does or not in terms of that. I don't think we get any of those figures.

Mr. WILLIAMS. We have statistics for three areas in the shelter program—books, lithographs and contributions—which could involve charitable deductions being used as a sheltering device. When we look at our statistics in those three areas through March of 1986 we see an appreciable drop in those three categories of shelters. I think a great deal of that has been our identification at the service centers, because we use a preidentification when the returns are filed. Our field people, our revenue agents and our tax auditors, have been alerted to these types of schemes now, and in those three particular areas I am pleased to say that we see a reduction in sheltering.

As I indicated to the chairman, in some other areas some of the promoters unfortunately have switched to other areas to shelter because I think we have done a very, very effective job with the tools that the Congress has given us.

Mr. SCHULZE. In your opinion, what percentage of those who take this deduction use it for tax avoidance? Do you think it is mainly used as a tax avoidance device?

Mr. OWENS. As a tax avoidance device? I am sure if you look at some of the claimed valuations and what the ultimate valuation is, that is the taxpayer's intent to avoid the tax, and we do end up with criminal cases in a number of these.

Mr. SCHULZE. From the other point of view, I am sure there are museums all over the country who are dependent upon those types of contributions, and probably have very wealthy patrons who, on a regular basis, go out and buy art and contribute it to museums. I would hesitate to characterize their actions as tax avoidance.

Mr. OWENS. I certainly do not have any intent to criticize the museums and those who are collecting artworks for the display or for the use of the museums, and I think at times the object may very well end up in a museum. Of course it has to be, in order to get the contribution deduction, some organization that is exempt, and that is why the additional requirement was placed in the 1984 act, which will require the recipient, if it is a museum, to report to the Revenue Service if that item is disposed of, sold or exchanged within 2 years. I think that will give us some information in terms of how much activity——

Mr. SCHULZE. Isn't that often done though? Don't museums sell minor art objects in order to get larger pools of money to buy major art objects?

Mr. OWENS. I am sure that is correct, and there is no intent in this to really stop those exchanges or in any way inhibit those. It is just a matter of information to us, and I think that would be of value to the Service, to see if in fact an item was sold for less than the contribution that was deducted. Certainly it would give us a clue as to whether maybe we ought to look at that return, or examine the return.

Let me add one other thing, Mr. Schulze, which I think goes back to the point you and also the chairman were making. I referred to it very briefly earlier. We have a study that is going on now, to look at this area of the tax returns, to see how many of them have taken a deduction for the contribution, and how many of them have specifically been examined, and, if in fact they were not examined, why. That analysis is going to take some time. We are

pulling the returns and looking at them. It will probably be available after the first of the year, though.

Mr. SCHULZE. I look forward to seeing your study.

I was interested to learn from the preliminary work of this hearing that an artist, if he contributes a painting or work of art directly to a museum, gets the deduction only for the cost of materials, paints and canvas. However, if he sells the painting and contributes the proceeds, the artist receives a much larger deduction. Should we look at this issue and develop a proposal to encourage artists to make more contributions to museums, or do you think current law is good the way it is?

Mr. OWENS. I think, it is rather clear, from our review of the statutory authority—and the responsibility is rather clear—that that is not permitted under the current statute. I think that Congress certainly could look at it. But on the other hand, in doing that, I think you would have to be, if Congress wanted to, very, very specific, because it opens a number of doors for any professional then to donate their talents and their time, and then take a deduction from that, whatever profession he or she might be in. So I think that it would require legislative change, and it would need to be very, very narrow if that would be the intent of Congress in order to do that.

Mr. SCHULZE. Thank you. Thank you for your testimony. Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman.

On page 6 you say that the Art Print Advisory Panel has been so successful that the charter has been allowed to drop or expire. Within your organization, who has picked up the oversight of that work product?

Mr. OWENS. Well, the material or the art prints, to the extent that they are found to be a problem, would still be referred to the Valuations Section and the Art Advisory Panel. So to the extent those cases would come in, we could still handle those. We just don't have right now, a member of the Advisory Panel with that kind of expertise. We have two or three unfilled spots which we could fill rather quickly with someone or some group of people, two or three, if in fact we saw that becoming a problem again.

There was a combination of things that occurred, some very well-known criminal cases which occurred, and they were primarily through the tax shelter area. So the efforts that we had in the shelter area have tended to eliminate that, and I think it was a failure. Just like other things, there is a group of promoters that start down the road, and they continue until we have some tools to deal with it.

Mr. ANTHONY. Certainly.

Are you satisfied that within your organization you still have the same type of capabilities of evaluating and prosecuting today as you did prior?

Mr. OWENS. Yes, sir, I am, and I am also quick to tell you that if in fact we saw it becoming a problem, if we began to see some more of those, we would quickly add some expertise to this Advisory Panel.

Mr. ANTHONY. I think that is good because when you look at that, you see what a great success you had; and then when you see it being abolished you get a little bit nervous.

In looking through some of the numbers, you have got a 413 billion drain due to charitable contributions in 1983. It is my understanding that the percentage of cases is on the rise.

In 1981 we changed the penalties to a sliding scale basis. Your testimony says you don't have enough history yet to ascertain whether or not that has actually worked. We stair-stepped the penalties in 1984. It would cause one maybe to draw the conclusion that we still have a problem on our hands. Is that a correct conclusion? Do we still have a problem on our hands with compliance in this area?

Mr. OWENS. Well, I think we have a problem, Mr. Anthony. I am not sure that it is a growing problem or whether or not it has stabilized. Let me explain a couple of points.

One is the penalty issue. As you just mentioned, that still has to take hold and take effect in some cases. The other thing, in looking at the figures, is that we changed the criteria of what the Art Advisory Panel looks at.

For a period of time, we only required agents to come in on those items where there was a single item of over $20,000 claimed as a charitable deduction. That has since been changed in the last couple of years, and we have changed it to say that any aggregate amount of $20,000 would come in.

Consequently, we are reviewing, or the Panel is reviewing, larger numbers, and they are making larger adjustments. So it would be difficult to absolutely conclude that in fact we have a severe problem; I think we have a problem; I just don't know that it is growing. But certainly there is a problem there.

Mr. ANTHONY. I am concerned about this because after looking at the slides that were put on the screen by Ms. Carolan, I can tell you that the average worker in my district doesn't have enough money to go pay that kind of money for those type prints or artifacts. Yet they read the paper and they see where some wealthy individual has taken a charitable contribution and as a result lowered their tax base to zero, and it causes a great deal of concern, and I think it has been part of the driving force behind the tax reform movement that is catching on right now.

I would encourage you to be ever vigilant in this area, because you have got certain people who can't participate, and if they can't participate because of their wealth, then they will find a way to participate illegally, and what they will do is overinflate other deductions. I think the work that you are doing has maybe more importance than just trying to catch somebody who is over- or undervaluating artwork.

One final line of inquiry——

Mr. SCHULZE. If the gentleman will yield, I know he didn't want to misstate, but it is impossible to reduce to zero your tax obligation because of charitable contributions. You can reduce it, but you cannot eliminate it completely.

Mr. ANTHONY. I will be happy to stand corrected. Substantially reduce. I have got a sawmill worker that wouldn't give you $5 for those squares that you showed up here on the screen. The Kenne-

dys or the Rockefellers may pay $21.5 million and slap it on their wall in their mansion, but I have got some Budweiser-Miller Lite drinking folks that could care less about what you put up on the screen, but they pay their fair amount of taxes and they don't mind doing it. But they don't like those multimillionaires not paying their share, and that was the point I was trying to make, Mr. Schulze.

One area that I personally have developed a good deal of interest in within the last 8 years is the growing area of artwork, I mean wildlife artwork, and I am not now talking about the Remingtons, the well-established ones. I am talking about something that seems to be a new phenomenon of carbons. I know one of the panels that is going to be here later today does have an auction and it is absolutely amazing to read about the prices some of these decoys sell for, one decoy going for $50,000, a Shaller or somebody else.

Do you have anybody on your panel that is looking into this new phenomenon, so that you will be ahead of the curve or with the curve as these pieces of art are contributed and charitable contributions are taken as a result of them?

Ms. CAROLAN. We don't have anyone yet. I would say we really do try to anticipate emerging areas, so as soon as we see a number of cases come in, we would probably do something about it. But as yet, while Americana is popular, actually we don't really review that many cases of it. I know that decoys do sell for a lot. But we would really try to anticipate it and, if it was a large area, do something to address that area.

Mr. OWENS. Let me add to that that we will certainly take that into consideration and have a watchful eye in that direction and move as fast as we need to.

Mr. ANTHONY. It is an area that just since I have been in Congress since 1978 and participated in as a spectator in some of the shows, I have learned a little bit more about that particular area. What I am hearing through the grapevine is that they are taking advantage of the same type evaluation schemes there, or the potential of doing it. It appears to me that you also have a very strong public service that you render also, and that is to keep credibility within the system itself, so that the artwork is properly appraised, so that if somebody does have a collection, they know the collection is valued for whatever they paid for it. So I think your section may be a lot more important than the general public perceives it to be, and I know that you know that it is important, and you have done good work.

I would like to compliment you on your outstanding record in the courtroom. I think that is wonderful.

What about counterfeits; I know a guy down in Arkansas that makes Remingtons and sells them. He sells two or three a week down there. What happens if I happen to buy a counterfeit Remington, and I truly think that it is an original but you come in and prove to me that it is a counterfeit? I just lose my deduction and then I go looking for the criminal to take care of it?

Mr. OWENS. That is correct. You go looking.

Mr. ANTHONY. What about penalties? Is a taxpayer caught under a penalty situation right there when in good faith he thinks it is an original but it is a counterfeit? Are penalties waived?

Mr. OWENS. There are some provisions to waive some of the penalties, provided the taxpayer has done his homework, investigated it and done everything that a reasonable person could do looking at it and getting it appraised in the transaction. The answer is yes, we can waive those.

Mr. ANTHONY. Is counterfeiting a problem?

Mr. OWENS. I don't think we have a major issue here, but certainly when it is detected, it is usually an area where there are large dollars involved in that particular item, because of the counterfeit as it relates to a particular artist and their artwork.

Sitting in on the Panel meetings, I have heard the comment made, that they would immediately recognize the fact that it was a fake because they looked at the photograph and they recognized it, and they know the piece of artwork very well. Certainly that is not something that I could do, but those people who have the expertise spot those rather quickly, and the value drops from $60,000 to $40,000 just as quickly.

Mr. ANTHONY. Thank you, Mr. Chairman. I would just like to commend you for the good work that you have done and encourage you to do an even better job.

Chairman PICKLE. Mr. Frenzel.

Mr. FRENZEL. Thank you, Mr. Chairman.

I want to thank the witnesses for their intriguing testimony.

Mr. Commissioner, in your statement you indicated that about a quarter of the taxpayers claiming charitable contributions in 1983 made noncash contributions, 7.8 million out of 32 million. This is on page 8 of your testimony. I assume that the lion's share of those were giving clothes to Goodwill, donation of farm lands, donations to churches, and other donations that are pretty easily valued in the market. Can you tell me what percentage of those 7.8 million might have given art objects that would fall under the jurisdiction of the section of the law we are looking at today?

Mr. OWENS. Mr. Frenzel, we do not have a breakout of that. I wish we did, and we are looking to try to do that.

Mr. FRENZEL. I assume it is a minuscule percentage; is that correct?

Mr. OWENS. In terms of the numbers, I am not sure of the actual numbers of taxpayers involved. When you look at the dollars, I would think it would go the other way, though. The dollars of the deductions would be much higher.

Mr. FRENZEL. You don't have a dollar figure either? Would the analysis that you are working on now reveal a dollar figure?

Mr. OWENS. What I have is the total dollar figure of the 7.8 million taxpayers, and that is $5.7 billion.

Mr. FRENZEL. That includes farms and buildings?

Mr. OWENS. Everything.

Mr. FRENZEL. Stock certificates?

Mr. OWENS. That is correct.

Mr. FRENZEL. Clothes?

Mr. OWENS. That is correct.

Mr. FRENZEL. And and all kinds of donations?

Mr. OWENS. That is correct.

Mr. FRENZEL. Would you be able to furnish us in January, when your ongoing analysis is able to develop that information, a figure

that will either give us the number of returns or the total dollars, preferably both?

Mr. OWENS. I believe we will be able to provide that. That is certainly our intent. We will have to wait until the study is over, but it is our intent to make that analysis and try to do that.

[The following was subsequently received:]

IRS' "WORKS OF ART CONTRIBUTION STUDY"

The Research Division's "Works of Art Contributions Study" will provide information on taxpayers who claimed charitable contributions deductions for works of art valued at $20,000 or more during tax year 1983. Specifically, the study will provide data on the numbers of taxpayers who claimed deductions for art works valued at $20,000 or more and the total amount of the contribution deductions claimed by these taxpayers. An ancillary objective is to determine what other types of assets valued at $20,000 or more were claimed as charitable contributions during this time and their approximate volumes.

Mr. FRENZEL. I hope you will be able to do that. Do you happen to know how many of the 7.8 million filers who claim charitable deduction were short-form filers?

Mr. OWENS. I do not know that. Let me see if any of the staff do. I am sure we have that figure, but I don't know if we have it with us.

Mr. FRENZEL. If you do, would you furnish it for the record?

Mr. OWENS. We will do that. I believe we would have that figure, though, at the office.

[The following was subsequently received:]

NUMBER OF FILERS CLAIMING THE CHARITABLE CONTRIBUTION DEDUCTION WHO USED A SHORT FORM (1040A OR 1040EZ)

For tax years 1983 and 1984 the short Forms 1040A and 1040EZ did not break-out charitable contributions of cash and noncash. The tabulated 7.8 million taxpayers claiming noncash contributions during tax year 1983 all filed Forms 1040. The reason for not distinguishing between cash and noncash contributions during 1983 and 1984 was that taxpayers who did not itemize their deductions were restricted to a $25 charitable deduction in tax year 1983 and a $75 deduction in tax year 1984. However, for tax year 1985 taxpayers who did not itemize were allowed to deduct one half of their total charitable deductions. Because the deduction amount could be significantly higher now than in previous years, some forms changes were made. Beginning with tax year 1985 nonitemizers can no longer claim noncash contribution deductions on Form 1040EZ but may still use the Form 1040A. In addition, the Form 1040A now includes a break-out of cash and noncash contributions. The Research Division will be gathering data on taxpayers who claimed noncash contributions during tax year 1985. Part of this data will include the number of short form filers (Forms 1040A) claiming noncash contributions. This data will be available by mid-1987.

Mr. FRENZEL. In those cases where noncash contributions are overvalued, particularly in the art field, is it the case that the taxpayers are generally innocently wrong, or is it that in the opinion of the people that handle the cases for you, they are knowingly wrong?

Mr. OWENS. Let me provide a little bit of background.

Mr. FRENZEL. I understand there are people who buy famous pictures, give them away in good faith and thus effect a substantial reduction in their taxes. But other situations that are ongoing scams.

Mr. OWENS. What you usually see is the piece of artwork will be purchased at one time, and then 1 to 2 years later the contribution will be deducted on the tax return, which gives time for, I guess,

some reasonable appreciation or some great amount of appreciation, depending on what the claim is, and then to take advantage of any capital gains rates and those sorts of things.

Mr. FRENZEL. If I may ask a question of Ms. Carolan. There are two museums in this country who have all the money. Are you using market prices based on their purchases, or how do you develop a price, if there is one of these great masterpieces for sale? There is a market price on any given day in an auction, but that market has been as thin as the ice on a pond on a summer day. How do you work against the problem of that very fickle kind of market?

Ms. CAROLAN. We recognize that there are certain museums that can pay anything, and we try to take that into account and give the most reasonable price, as defined in the fair market value definition. But, yes, some prices are out of line, clearly so high and people——

Mr. FRENZEL. The Getty Museum?

Ms. CAROLAN. They can get any price.

Mr. FRENZEL. I hope you are not using their prices.

Ms. CAROLAN. No.

Mr. FRENZEL. The next question is this. You are in charge of this particular area of enforcement. Insofar as you are aware, are you satisfied that the tools you have are adequate to deal with the problem, the legal tools, and the enforcement tools?

Ms. CAROLAN. Well, as Mr. Owens said before, for a lot of the new legal tools with penalties for the appraiser and for the taxpayer it is really too early to tell what kind of effect they will have. I think after we have more time and experience with the new tax changes we would be in a better position to say what more we might need.

Mr. FRENZEL. Yes. But I assume that the sophisticated recipients of these objects of art are aware that there are now serious penalties. They are probably a little more cautious, at least if they have good legal counsel. I would like to ask you also about this question of self-creative art. I assume that we presently discourage such gifts under current law because it was a great opportunity for abuse.

Is it, however, not simply a crutch for us and for the IRS to deny a person the ability to give his or her own work where works of similar value could be given? Couldn't we invent some rules that would protect us against abuse? In other words, isn't your department good enough to be able to value those works of art?

Ms. CAROLAN. We would value them. I think you are right about this, in the late sixties when self-created art was no longer allowed, that is when the Art Panel was established.

Mr. FRENZEL. I have got a closet full of doodles I am going to give to the first guy who will take them.

Ms. CAROLAN. It is a difficult problem and there are a number of bills up here that are trying to deal with this area.

Mr. FRENZEL. I assume we are talking about a very small class of taxpayers who will want to give away self-created works. Does that restriction apply to their heirs? For instance, if I got to the closet of my grandmother whose name happened to be Moses, and give

away her stuff, do I have the ability to do that, or does the self-created hex hang over those objects of art?

Mr. OWENS. If I understand you correctly, Mr. Frenzel, I think what would occur then is that it would fall within the estate tax and would be evaluated for estate tax purposes.

Mr. FRENZEL. Whatever the valuation was when making the gift?

Mr. OWENS. Right.

Mr. FRENZEL. So it applies only to the creative person?

Mr. OWENS. Right.

Mr. FRENZEL. All right, I will look forward to getting some of that information which we discussed at the beginning, when it is available for the record. I thank you.

Chairman PICKLE. I know we have other panels that we must move forward with, but before you leave let me ask the commissioner again: On page 5 of your testimony you said that, "The panel recommended an adjustment valuation of approximately half of the items received." This was for the period 1977–85. Are you saying that approximately one-half of the people who claim a charitable contribution overvaluate their donations?

Mr. OWENS. Yes, Mr. Chairman, that is correct.

Chairman PICKLE. One half of the people who are claiming a charitable deduction on artwork we will say overvaluate, and I assume further that you are saying that you made adjustments in amounts from $425 million down to $115 million. That would mean that you made an adjustment downward to almost 20 percent as an average?

Mr. OWENS. Right, $110 million of the $525 million was adjusted downward.

Chairman PICKLE. At this point half the people who claim a charitable deduction overvaluate and in an amount of approximately at least 20 percent on an average?

Mr. OWENS. That is half the items, Mr. Chairman, not necessarily the taxpayers. There may be more than one person——

Chairman PICKLE. If that is the case, then it is well that we have these penalties, because human nature being what it is, artists are people who have artwork overvaluate and undervaluated similarly in almost the same percentages, as I understand it. We have these penalties, and you are saying that they haven't been in force long enough, and if you are 2 or 3 years behind now, it seems to me like you would need to step up your reviews.

Do you have enough budget funds to step up this program, this investigation, and do you need additional funds, and if so, what amounts?

Mr. OWENS. Mr. Chairman, we have allocated funds to this program to the extent that they are needed. I think one of the issues here is the time of the receipt of the returns. Let's look at the 1984 taxpayer return: it was not due until April 15, 1985, but with extensions—and I am not sure what the percentage of these is where they have the large contribution deductions—but more and more extensions are being filed, so as a result of that, receipt is delayed until August 15.

So those returns may not get into the art stream until the latter part of 1985. So it is almost a year before we have the return. If it

goes into the appeals area and there is no agreement on it, it takes 2 to 3 years on those cases.

Chairman PICKLE. Are you saying, Mr. Commissioner, that you need additional funds?

Mr. OWENS. No; we have allocated sufficient funds in this area to meet the needs that we have.

Chairman PICKLE. Do you believe that the current law penalties as well as the new substantiation of donee reporting requirements are adequate to address any existing noncompliance problem?

Mr. OWENS. I believe that the additional provisions passed in 1984, which were effective December 31, 1984, will make a substantial difference in terms of the information that must be provided to us when the deduction exceeds her $5,000. There is very specific and detailed information requested and the donee has to sign that, so I think it will police it very well.

Chairman PICKLE. Let me ask you how it is working in general are the art dealers throughout the United States in general supportive of the Art Advisory Panel section and the Art Evaluation Section? Do they support what you are doing, or are you in controversy with them in general? We will hear from some of these this morning, I am sure.

Mr. OWENS. I was just checking here. I am not aware of any major controversy. I think in general that the industry is supportive, has been supportive, and I think those Panel members who serve with no pay, with the expertise that they have, provide a very significant service to us and to the public for what they do.

Chairman PICKLE. When I say art dealers, I am talking about appraisers in general.

Mr. OWENS. Yes.

Chairman PICKLE. I have met with a group of appraisers and art dealers in my district at one time about a year ago, and I think what they were asking for was recognition for the work that they do, and that they welcomed the chance to be so recognized if administered properly. I guess you come to the question what is a qualified appraiser. It seems to me like your language is very broad on a qualified appraiser. Should that be made more specific? You don't think that is a problem?

Mr. OWENS. I am reminded, Mr. Chairman, of discussions that have been going on now for at least a few weeks with Treasury that relate to appraisers, in terms of what type of additional authority the Service might be able to use as it relates to——

Chairman PICKLE. Will you let the committee know what recommendations they might make?

Mr. OWENS. Yes; particularly as it relates to abuses that there might be in using the system.

[The following was subsequently received:]

TREASURY ACTIONS RELATED TO APPRAISERS

The Treasury Department has under consideration various proposals with regard to appraisers but is not yet prepared to offer recommendations for statutory change. When it does, the Service will of course share the information with the Subcommittee.

Chairman PICKLE. One last question then. How many times have penalties been imposed for overvaluation or undervaluation? Can you tell me how many times you have actually assessed penalties?

Mr. OWENS. Mr. Chairman, the section 6659 penalty, which is the valuation or overstatement penalty for the purposes of income tax, was assessed 33,025 times for fiscal year 1985. Section 6661, which is substantial understatement of the liability, which may be applicable to these and it may not be—these are not necessarily always in the art area—we assessed 8,662 of those. And in the aiding and abetting understating of the tax liability, the 6701 penalties, we assessed 1,053. That is for fiscal year 1985. You must bear in mind that all of these do not necessarily relate to artwork. It may be other areas where the penalties apply, and I cannot separate those out for you today. I just don't have that information.

Chairman PICKLE. I don't know whether I can understand all these figures, but I will look at your testimony. I am trying to make some evaluation in my own mind. Are you actually assessing penalties?

Mr. OWENS. Yes; we are actually assessing penalties.

Chairman PICKLE. And I would need to know in what number.

Mr. OWENS. As I said earlier, it is a very complex area inasmuch as there are a whole host of penalties that could be applied, and some only apply after others apply. As I said for section 6659 of the code, which is specifically valuation or overstatements, there were over 33,000 of those assessed in fiscal year 1985.

Chairman PICKLE. It seems to me then, Mr. Owens, that this hearing ought to reflect that the Internal Revenue Service, based on statistics you have given us, publicly states that at least one-half the donors, contributors, charitable contributions, overevaluate up to 25 or more percent, and that you recognize this and that you are stepping up your reviews, working closely with the dealers and that the public should realize that they are subject to penalties for overvaluation or undervaluation.

Mr. OWENS. I agree with that, Mr. Chairman, completely, and we are doing that and we will continue to assess those penalties. These are civil penalties which are ongoing right now.

Chairman PICKLE. I am going to cease asking questions. We must move forward.

You touched on another subject that it seems to me ought to be looked at, and that is are there criminal penalties actually being assessed in these cases?

Mr. OWENS. We have a number of criminal cases, yes, that are going on now. That is something I cannot discuss here, but they are there, yes.

Chairman PICKLE. I don't mean criminal with respect to say a man who is dealing with a third party. For example, if you buy this painting, I will get it placed and can give you five times the deductions on it if you give it to me and I will give it to a museum. That would be criminal.

Is a taxpayer subject to a criminal penalty if when making a contribution he knows that the value of his painting is $1,000 but he values it at $50,000?

Mr. OWENS. Certainly it would be subject to a criminal penalty. Of course the proof would be the intent, whether it was the intent to avoid the payment of taxes, yes, sir.

Chairman PICKLE. I agree with Mr. Anthony and the other members here that I think you are performing a valuable service, and if you need additional help on it, we ought to give you every consideration. We appreciate your testimony.

Mr. Frenzel.

Mr. FRENZEL. Mr. Chairman, may I ask another question? Ms. Carolan, I understand that the Commission evaluates art for both estate tax and contribution purposes, and the Panel doesn't know whether the taxpayer is trying to get a high evaluation or a low evaluation.

Ms. CAROLAN. That is correct.

Mr. FRENZEL. Can you tell me what the percentage break in either value of the cases are between estates and contributions? I assume there are more for estate purposes?

Ms. CAROLAN. There used to be more for estate taxes, but since the estate limit has gone up so much more, now we really do more contributions.

Mr. FRENZEL. When a painting, an expensive artwork, is sold at auction, the auction house takes the commission at both ends, typically 10 percent at each end as I understand.

Ms. CAROLAN. Ten percent.

Mr. FRENZEL. A total of 20 percent. Do you factor those selling costs and so forth into your market value?

Ms. CAROLAN. For all auctions we factor in the 10 percent that the buyer has to pay to take it out, yes. We add 10 percent to it.

Mr. FRENZEL. So you take only half.

Ms. CAROLAN. Yes; we take only half, in valuation.

Mr. FRENZEL. Thank you very much.

Chairman PICKLE. Commissioner, before you leave, Mr. Downey, a member of this committee, who is chairman of the art caucus, wanted to ask you this question. He says a member of the Art Advisory Panel, Mr. Ellsworth—who will testify later today—makes certain recommendations in his prepared statement. He recommends that the appraiser summary form be forwarded directly to the Art Valuation Section.

Mr. Ellsworth states that such a procedure would help the Section get a better grip on the universe of artwork evaluation. Do you think this is a good idea, that is to extend the appraisal summary, send it directly to the Art Valuation Section? Do you have any commentary on that?

Mr. OWENS. Mr. Chairman, I wasn't aware of that. We will certainly take a look at that to see if any of those suggestions might be helpful to the Panel.

Chairman PICKLE. Will you give us your response to that.

Mr. OWENS. Certainly, I will be happy to.

[The following was subsequently received:]

IRS RESPONSE TO SUGGESTION BY MR. ROBERT ELLSWORTH

The existing Form 8283 makes Mr. Ellsworth's suggestion impossible because it does not include a means of identifying the type of non-cash contribution.

Consequently, the Art Valuation Section and the Research Division are working with the Tax Forms and Publications Division to revise the Form 8283 so that the type of property can easily be indentified. The type of asset involved could then be coded and transcribed during the processing of the return, and an automatic indentification and referral system established. The resulting data could provide invaluable statistical information for the Art Valuation Section as well as other Service personnel involved in charitable contributions.

[IRS responses to subcommittee questions follow:]

DEPUTY COMMISSIONER OF INTERNAL REVENUE
Washington, DC 20224

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Ways and Means
Subcommittee on Oversight

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30 DEC 1986

Ways and Means
Subcommittee on Oversight

The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
1105 Longworth House Office Building
Washington, DC 20515

Dear Mr. Chairman:

Enclosed are responses to the questions on the Commissioner's Art Advisory Panel posed in your letter dated August 13, 1986. Also included are comments on the list of recommendations made to improve the Panel's activities. Some of the responses to the questions and recommendations have already been provided with the edited transcript.

We regret the delay in responding. Please let me know if there is anything further you require.

Sincerely,

James I. Owens
Deputy Commissioner

Enclosures

QUESTIONS

1. Do you believe that the current law penalties as well as the new substantiation and donee reporting requirements are adequate to address any existing non-compliance problems?

Yes. We feel that the penalty is easy to understand and administer and, therefore, is an effective deterrent to the willful overvaluation of donated property.

2. Are the new penalties or substantiation requirements enacted in DEFRA (The Deficit Reduction Act of 1984) causing the IRS any particular administrative problems?

The two principal penalties created by DEFRA were Penalties for Aiding and Abetting Understatement of Tax Liability (IRC 6701) and Failure to Furnish Information Regarding Tax Shelters (IRC 6707). No problems have been encountered in administering these penalties.

3. Has the Art Valuation Section found that certain charitable institutions consistently accept overvaluated art objects? If so, why?

-- What can be done about the problem?

-- Is further legislative action needed or can this problem best be handled administratively?

Institutions have been identified from time to time that accept items which, when reviewed by the Art Advisory Panel, have been found to be overvalued and not as described in the taxpayer's appraisal. If the Art Valuation Section detects a consistent pattern, then the appropriate IRS function is notified to investigate the situation further. We believe this is the best approach.

4. How has the appraisal requirement facilitated compliance?

Since the new appraisal requirements were not published until December 31, 1984 for the 1985 tax year (returns for which was not filed until April 1986), it is too early to assess their effectiveness. However, these new appraisal requirements should aid compliance by making it mandatory that the taxpayer provide better information.

5. The proposed regulations state that a "qualified appraiser" means an appraiser qualified to make appraisals of the property donated.

-- Why is the definition of "qualified appraiser" so broad and so vague?

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-- Clarify what constitutes a "qualified" appraiser and what constitutes a fraudulent appraiser.

In defining the term qualified appraiser, the Service had to take into consideration the conflicting interests of appraisal groups and donors and donees. Appraisal groups support a definition that ensures that only truly qualified persons be permitted to prepare qualified appraisals. For example, appraisal groups recommended defining a qualified appraiser as an individual who has completed a rigid program of education, testing and certification through a professional organization which self-regulates its members. On the other hand, donors and donees need a definition that provides reasonable certainty and objectivity.

The definition suggested by appraisal groups was not used because it is not susceptible to reasonably certain application by donors, who are unable to evaluate particular organizations. Instead, the Service adopted in the temporary regulations a definition that reconciles the conflicting interests of appraisal groups and donors and donees. Section 1.170A-13T (c)(5)(i) defines a qualified appraiser as an individual who includes on the appraisal summary a declaration that --

(A) The individual holds himself or herself out to the public as an appraiser;

(B) Because of the appraiser's qualifications as described in the appraisal (such as the appraiser's background, experience, education, and membership, if any, in professional appraisal associations), the appraiser is qualified to make appraisals of the type of property being valued;

(C) The appraiser is not the donor, the donee, a party to the transaction in which the donor acquired the property, employed by or related to any of the foregoing persons, or a person whose relationship to any of the foregoing persons would cause a reasonable person to question the appraiser's independence; and

(D) The appraiser understands that a false or fraudulent overstatement of the value of the property described in the qualified appraisal or appraisal summary may subject the appraiser to a civil penalty under section 6701 for aiding and abeting an understatement of tax liability, and consequently the appraiser may have appraisals disregarded pursuant to 31 U.S.C. 330 (c).

Reliance upon the execution of such a declaration to define the term qualified appraiser is intended to provide certainty to donors, while attempting to ensure

that only qualified individuals prepare appraisals. The Service recognizes that some individuals who have no experience or training in appraising the type of property being donated may be willing to sign such a declaration and to knowingly prepare an appraisal that overvalues the donated property. Such an individual is a fraudulent appraiser. If an appraiser overvalues the donated property, however, the Service may assert the section 6701 civil penalty against the appraiser. As a result, such an individual may have appraisals disregarded pursuant to 31 U.S.C. 330 (c). Authority for disqualification is found in section 156 of the Deficit Reduction Act of 1984.

6. Is a valuation of $5,000 the reasonable point at which an appraisal summary should be attached to the tax return?

The appraisal summary form is actually used for any contribution of $500 or more. Taxpayers who make contributions exceeding $500 must complete Section A, and those with contributions exceeding $5,000 must complete Section B. At the present time, we have no evidence to suggest these dollar thresholds should be modified.

7. In your testimony, IRS noted that a quarter of taxpayers claiming charitable contributions in 1983 made non-cash contributions that totaled $7.8 million. (sic -- $5.8 billion)

(a) What percentage of those $5.8 billion in contributions fall within the purview of contributions reviewed by the Art Advisory Panel?

Our past recordkeeping system does not enable us to accurately answer this question. Although we publish annual Art Panel reports, these statistics represent cases reviewed in one calendar year from several different tax years. For example, in 1983, the Panel reviewed 568 items representing 161 taxpayer cases with an aggregate taxpayer valuation of $72,185,000. The cases reviewed in 1983 included 1979-1982 tax years. In 1985, the Panel reviewed 1,538 items representing 226 taxpayer cases with an aggregate taxpayer valuation of $67,885,000. These cases included 1981-1984 tax years.

The Art Valuation Section is currently setting up a data base containing all Panel meeting information. In the future the total taxpayer valuation for specific tax years will be available.

(b) How many of the filers, who claimed the $7.8 million (sic -- $5.8 billion) in non-cash contributions, are "short form" filers?

A response to this question from Mr. Frenzel was provided at p. 51b of the edited transcript. The response follows:

For tax years 1983 and 1984 the short Forms 1040A and 1040EZ did not break-out charitable contributions of cash and noncash. The tabulated 7.8 million taxpayers claiming noncash contributions during tax year 1983 all filed Forms 1040. The reason for not distinguishing between cash and noncash contributions during 1983 and 1984 was that taxpayers who did not itemize their deductions were restricted to a $25 charitable deduction in tax year 1983 and a $75 deduction in tax year 1984. However, for tax year 1985, taxpayers who did not itemize were allowed to deduct one half of their total charitable deductions. Because the deduction amount could be significantly higher now than in previous years, some forms changes were made. Beginning with tax year 1985, non-itemizers can no longer claim noncash contribution deductions on Form 1040EZ, but may still use the Form 1040A. In addition, the Form 1040A now includes a break-out of cash and noncash contributions. The Research Division will be gathering data on taxpayers who claimed noncash contributions during tax year 1985. Part of this data will include the number of short form filers (Forms 1040A) claiming noncash contributions. This data will be available by mid-1987.

(c) What is the percentage breakdown of cases that are estate tax cases versus income tax deduction cases? Please discuss the reasons behind the trend that cases are shifting from estate to art contributions for income tax purposes?

The table below gives both the case and item breakdown by estates and contributions reviewed by the Art Panel between 1981-1985. Since the Panel reports are calendar year figures, an accurate answer for any tax year is not possible. However, from our figures it is evident that the percentage of estate cases and items reviewed by the Art Panel has shifted since 1983. We believe this shift of emphasis is due to the expansion of the Panel into two new art areas which consist almost entirely of contribution cases.

Cases & Items Reviewed by the Art Panel

ESTATE:	85	84	83	82	81
T/P Cases	53(23%)	44(17%)	73(45%)	82(41%)	72(41%)
Items	272	307	342	414	308
CONTRIBUTION:					
T/P Cases	173(77%)	214(83%)	88(55%)	116(59%)	102(59%)
Items	1266	1439	226	313	177

8. Is there some way that we can develop a system that would encourage artists themselves to make more contributions to museums?

Prior to 1969, an artist was allowed to take a deduction for contributions of self-created art. This proved to be a significant abuse area and was eliminated by the Congress in 1969. Legislation would have to be passed to allow artists to once again claim a deduction based on fair market value. Currently, under Income Tax Regulation 1.170A-4(b)(1), a charitable contribution deduction of "a work of art created by the donor" is defined as ordinary income property and as such is limited to the artist/donor's basis or the cost of materials (i.e., paint and canvas).

RECOMMENDATIONS

1. A copy of the Appraisal Form (Form 8283), which is submitted with the taxpayer's return, should be directly forwarded to the Art Valuation Section.

   A response to this suggestion by Mr. Ellsworth was provided at p. 64a of the edited transcript, and states the following:

   The existing Form 8283 makes Mr. Ellsworth's suggestion impossible because it does not include a means of identifying the type of non-cash contribution.

   Consequently, the Art Valuation Section and the Research Division are working with the Tax Forms and Publications Division to revise the Form 8283 so that the type of property can easily be identified. The type of asset involved could then be coded and transcribed during the processing of the return, and an automatice identification and referral system established. The resulting data could provide invaluable statistical information for the Art Valuation Section as well as other Service personnel involved in charitable contributions.

2. The Art Valuation Section should begin reviewing contributions of wildlife artwork, such as replica woodcarved duck decoys and similar pieces of artwork, that are appraised at high values and donated as charitable contributions.

   The Art Valuation Section has reviewed and will continue to review American folk art, such as duck decoys. If the case has been selected for audit and has a value of $20,000 or more, it must be sent to the National Office for review like other art areas. While duck decoys have sold recently in the six figures range and have received much publicity, the Section has not received a large volume of cases in this art area to date.

3. The Art Valuation Section should look at the deduction that can be taken by the artist who contributes his work.

   Under Income Tax Regulation 1.170A-4(b)(1), a charitable contribution deduction of "a work of art created by the donor" is defined as ordinary income property and as such is limited to the artist/donor's basis or the cost of materials (i.e., paint and canvas). Legislation would be needed to allow artists to claim deductions on donations of their work. (See response to Question 8.)

4. The Art Valuation Section should have a good photography budget. This is important because the determinations of the Art Panels seem, in most cases, to depend upon photographs of the artwork.

The Art Valuation Section is very aware of the need for good quality photographic reproductions for Panel review. In the past, the Section often had the cheaper black and white reproductions made, but now the more expensive quality color reproductions by a professional photographic laboratory are considered all-important. The Art Section has made strides to improve in this area, such as increasing annual Panel photo lab expenditures from about $21,000 in 1981 to $141,000 in 1986.

5. The quality of the photograph submitted should be improved. It is suggested that the donor pay for that quality in the form of a color transparency, and the expense be tax deductible.

A response to this suggestion by Messrs. Burke, Nash, and Rosenberg was provided at p. 103a of the edited transcript. That reply follows:

IRM 42(16)4.3 outlines the procedures for National Office art valuation assistance and the information necessary for review. Regarding photography, the manual indicates "a professional quality 8 inch by 10 inch black and white photograph and a 5 inch by 7 inch color transparency of the object."

Although the IRS requires professional quality photographs, the photographic documenation submitted is often of poor quality.

The Art Valuation Section is making a concerted effort to enforce this manual requirement. We notifiy field agents that the case cannot be processed unless professional quality photographs are submitted.

6. The donee institution that accepts a contribution should submit a copy of Form 8283 directly to the Art Valuation Section.

Implementation of the proposed changes to Form 8283 discussed under the first recommendation would provide a revised Form 8283 to the section and satisfy this recommendation.

7. The term of service for a member of the Art Advisory Panel should be longer than three years, especially in the Far Eastern and Asian art fields. Former panelists should be asked to serve again after a suitable period.

A response to this suggestion by Mr. Ellsworth was provided at p. 103c of the edited transcript, and states the following:

The IRS Chief Counsel was contacted to explore the term for special government employees or experts. It was determined that experts could only by appointed for one-year terms but could in fact be re-appointed indefinitely as long as the appointment was terminated and reinstituted annually.

We will now be able to extend Panelists' terms to more than two years. However, rotation of members to ensure a balance of viewpoints and varied representation will continue to be an important consideration.

8. All contributions appraised at $35,000 or more should be reviewed by the Art Advisory Panel.

As a practical matter, this happens now. Under Panel rules, all cases selected for audit with a claimed value of $20,000 or more are reviewed in the National Office by either the Panel or the Valuation Section. Those items in the painting, sculpture, Far Eastern, Asian, Primitive and Pre-Columbian areas are reviewed by the Art Advisory Panel. Items in other art areas are reviewed by National Office art appraisers. Lower-valued items are reviewed because these categories have been identified as abuse areas. (See response to question 12.)

9. The IRS needs additional equipment to provide better copies of photographs submitted by taxpayers.

Recognizing this need, equipment was requisitioned in August 1986 for the Art Valuation Section included a light table (to view color transparencies), a slide table (to view color slides), and a color copier (to reproduce comparable sales information for Panel meetings and for valuation reports).

10. The taxpayer should have an obligation to provide more complete information about the work of art submitted for review, in cases where there is a dispute between the taxpayer and the Art Advisory Panel on the appraised value of the contribution.

After the Panel has recommended a value on a specific work of art, the taxpayer has the opportunity to request a reconsideration by submitting new documentation, such as comparable sales, better photographs, or a new appraisal.

This new information is then submitted to the Panel. It is in the taxpayer's best interest to provide the Panel with any and all information which will help his or her case.

11. Actual viewing of artwork should be arranged when a determination from the photograph is impossible.

When determination of value from the photograph is impossible, the Art Valuation Section tries to arrange for one of the Panelists or a noted expert to inspect the object. Over the years, many Panelists have assisted the Service in resolving disputes by viewing the actual works of art. Panelists on numerous occasions have accompanied staff appraisers to museums, private homes, and warehouses to inspect, first-hand, actual works of art. If there is a question about the art work's authenticity, every effort is made to have it inspected by a knowledgeable expert.

12. The $20,000 valuation level for mandatory screening by the Panel should, in the case of African, Oceanic and Pre-Columbian works of art, be reduced to $5,000.

A response to this suggestion by Mr. Sieber was provided at p. 103b of the edited transcript. That reply stated:

The IRS Chief Counsel was contacted to explore the term length of special government employees or experts. It was determined that experts could only be appointed for one-year terms but could in fact be re-appointed indefinitely as long as the appointment was terminated and reinstituted annually.

We will now be able to extend Panelists' terms to more than 2 years. However, rotation of members to ensure a balance of viewpoints and varied representation will continue to be an important consideration.

13. The taxpayer should be held accountable, as well as the appraiser, for gross discrepancies between the taxpayer's cost and the valuation of charitable contributions that have not legitimately appreciated.

Code Section 6659 already provides for penalties to the taxpayer for overvaluation. The taxpayer may be liable for a penalty of 30% of the additional tax if the value (or adjusted basis) of any donated property claimed on the tax return is 150% or more above the correct amount. If the appraiser of the donated property is found guilty of aiding and assisting in an understatement of tax liability, a $1,000 civil penalty could be imposed under section 6701. Furthermore, under 31 U.S.C., 330(c),

added by section 156 of P.L. 98-369, assessment of the penalty may bar the appraiser from presenting evidence, such as an appraisal, in any administrative proceeding before the Internal Revenue Service.

14. The donee institution should have no role in valuing a gift or confirming the value assigned to it by the donor. Including the donee in the valuation process would be a serious mistake.

The regulations discussed in the response to question 5 are very specific as to who is not qualified to make appraisals of donated property. The donee, any person employed by the donee, or any person who bears a relationship to the donee under the related party rules is strictly prohibited from making appraisals.

15. Changes to the current law should be considered only after the impact of the DEFRA changes can be evaluated and analyzed. Two or three more years should pass before assembling any data to assess the effectiveness of the penalties.

We agree that two or three more years are needed to accurately assess the effectiveness of these penalties.

16. The preliminary regulations on appraisals, issued on December 31, 1984, should be finalized as soon as possible, taking into account comments received for the record and statements from the June 28, 1984, Treasury hearings on the regulations.

Following publication of the temporary regulations, 152 written comments were received. In addition, oral comments were received at the public hearing and through telephone calls. After careful consideration of the written and oral comments, a draft of the final regulations was prepared. Currently the draft is circulating within the Internal Revenue Service and at Treasury for review. Upon completion of that review the draft will be prepared for publication. Although we are actively working toward the finalization of these important regulations, we are not able to predict when they will be published. As you are aware, IRS has a large volume of regulations under development, and the staffs here and at Treasury are involved with tax reform implementation.

17. Encourage broader scope of participation on the Art Advisory Panel and continue to limit a Panel Member's term (to avoid allegations of cronyism or an "old boy" network).

The difficulty with "broader scope" is the paucity of qualified people who have national and international reputations and experience in the art field. It is clear that the Panel cannot be better than the Panelists who compose it. The credibility of the Panel is dependent on selecting noted experts in specific art areas.

We are very concerned with balancing the Panel to provide varied points of view. To ensure optimum representation of divergent seller and buyer perspectives regarding art market trends and values, the Panel is composed of art dealers, auction representatives, museum directors, curators and scholars. Geographic balance is also sought. Specialists in different schools and periods are selected. All Panelists are subject to review and reappointment annually. Frequent changes in membership helps ensure a balanced point of view.

18. Members should be barred from advertising their ties to the Art Advisory Panel while they are currently serving. In their work for a client, former Panel members should not automatically receive special treatment from the Internal Revenue Service because of their previous association.

We are not aware of Panelists' actively advertising their ties to IRS, but the list of members of the Art Advisory Panel is public information. The names of the Panelists making the determinations are also attached to each Panel report. During their term as Panel members, they must refrain from making appraisals for tax purposes.

Former Panel members do not receive special treatment when the Panel reviews their appraisals. We are very conscious of this potential problem, which is one of the reasons why the identity of the appraiser and taxpayer are not customarily provided to the Panelists in their review.

19. Expand the Panel to include other specialists in the art and artifacts area, i.e., folk art; gems, minerals and jewelry; furniture; rare books and manuscripts, etc. Such panels would probably need to meet only once or twice a year.

A gem and mineral panel was considered as far back as 1983, but was rejected for the following reasons: 1) photographs are impossible to use in reviewing gems, 2) gems must be directly examined, and 3) extensive equipment is necessary for proper examination by a gemologist. It was determined that it was more effective to hire outside gemologists to appraise these works. We hired outside experts in these cases and, in the six gem cases that have been tried to date, the Government's position has been upheld.

Presently, we see no need for a gem panel. Although gem shelters, like print shelters, were popular in the late 1970's and early 1980's, the number of gem cases has drastically declined.

To date, the volume of cases in the other collectible areas mentioned have not warranted expansion. If the volume increases in these areas or others, we would immediately seek to expand the Panel to include appropriate specialists.

20. In line with other federal appointments to advisory panels, qualified women and minorities also should be appointed to the Art Advisory Panel on a regular basis.

From its inception, the Art Panel has had women and minorities as members. We encourage participation on the Panel by qualified members of these groups.

21. A cadre of experts from the non-professional ranks of collectors, patrons and critics, who would be sworn to the same restrictions and discretion as any other IRS employee, should be identified and asked to participate, "pro bono", on a selective basis when their services are required.

This is a very good recommendation since the expertise of many collectors, patrons, and critics is nationally and internationally known and recognized. We will request an opinion from Chief Counsel regarding the possibility of appointing Panelists from these non-professional ranks.

22. More meetings should be held. No Panel can do justice to 300 cases in a day even if, as one Internal Revenue Service witness testified, "they work through lunch". (300 items not cases)

The Panel is now meeting six times a year. In 1985, 1538 items were reviewed involving 226 taxpayer cases. We do have lunch brought in to the Panelists and they are given breaks during the day. The one-day meeting has evolved as an accommodation to these very busy people. Weeks before the meeting, detailed information and photographs of the objects are sent to the Panelists. They review this material, do their own research, and by the time of the meeting have formulated their individual opinions as to value and authenticity. As a result, the meeting moves quickly with lengthy discussion on only a handful of problem pieces. More frequent meetings would probably mean only partial use of a meeting day, increased Panelist travel time and expense, and loss of staff time devoted to preparation for meetings and the all-important report writing after meetings. The actual meeting day is only part of the larger picture.

Chairman PICKLE. Thank you all very much.

Our first panel will consist of Mr. James Burke, Mr. Robert Ellsworth, Mr. David Nash, Mr. Alexandre Rosenberg, and Mr. Roy Sieber.

If you gentlemen will take your positions at the witness table. Mr. James Burke is director of the St. Louis Art Museum, St. Louis, MO; Mr. Robert Ellsworth represents the R.H. Ellsworth, Inc., New York, NY; Mr. David Nash is the director of Fine Arts, Sotheby, Parke Bernet, Inc., New York, NY; Mr. Alexandre Rosenberg representing Paul Rosenberg & Co., New York; Mr. Roy Sieber is Associate Director for Collections and Research, National Museum of African Art, Smithsonian Institution, Washington, DC, and Rudy professor of fine arts, School of Fine Arts, Indiana University.

We are pleased to have you gentlemen here. We will start off first with the testimony of Mr. Burke. If you will proceed.

STATEMENT OF JAMES BURKE, DIRECTOR, ST. LOUIS ART MUSEUM, ST. LOUIS, MO

[The prepared statement begins at p. 149.]

Mr. BURKE. Thank you, Mr. Chairman.

I am James Burke with the St. Louis Art Museum. I am delighted to be here today to discuss the art of appraisal and evaluation process of IRS. I was a member of the IRS Print Panel from 1981 to 1983, which was much earlier, dealing almost entirely with tax sheltered publishing of multiple editions of lithographs, silk screens, and other art prints. During the 4-year life of that specialty convened panel, from 1981 to 1983, as you heard earlier, the adjustments which were made were absolutely enormous, running to $219-plus million. The IRS staff can give you a better judgment on this in statistics than I ever could, but my point was to state today that the cases we reviewed were greatly overvalued by the taxpayers involved, and the result and the claims and gain for the Treasury throughout, very silly claims were not supported by good economic sense nor by any social or artistic utility, at least in my opinion.

Since 1985 I have been a member of the Commissioner's Art Advisory Panel, the subject of today's discussion. Like the Print Panel, I felt it could have a very useful effect.

Like many colleagues in the large museums with comprehensive collections, I have closely followed the national and international art market in a number of specific areas for over 20 years. With our six curators and their assistants, I follow the market closely and shop widely to make our choices for acquisitions.

Our museum's intention was to cover civilization from cave painting until the present day. But since we don't have a direct commercial stake in the market, we represent a free-ranging buyer's attitude.

The Art Advisory Panel is a good, honest arbitration board, acting between the claimants, the IRS staff and the Tax Court. Over the years of its existence, it has developed an excellent reputation for diligence and avoidance of conflicts of interest. The presence and actions of this panel of experts has surely avoided much

litigation between taxpayers and the IRS, just because its members are so often well-known experts in the art market, being drawn from the ranks of auctioneers, art dealers and museums.

By the way of a rough guess, I would estimate that about 25 percent of the evaluations that we review are accepted without question, they are appraised properly in my judgment, the first time out, about 50 percent are off by a small measure, by say 20 percent or so, and the remaining 25 percent of what we see are so over or under as to be ridiculous.

It would be very, very apparent. Of course this is the case where the biggest tax abuses lie and the one we want to be concerned with. Since we review both the estates and the charitable contributions, it is worth mentioning that staff only shows us the artwork and the claim of value, and our neutrality is not brought into issue as to the other factors in the thing.

I do feel very much at this point that the evaluation and review process at IRS is working very smartly, has a diligent and very excellent staff and a very good productivity. I do feel that the committee should assure that they have a good photography budget, which is terribly important for the judgments of the panels seem in most cases to depend on that.

The presence of the panel has had a very healthy cautionary effect on overevaluation problems in the past. I see fewer cases of people talking about taking a shot at the Government than I heard about say 10 or 15 years ago. I believe that the effectiveness is therefore very, very strong.

I urge the committee's continuing support of this valuable process. There is no doubt in my mind that the overevaluation abuses are greatly diminished from what they were a few years ago.

Chairman PICKLE. Thank you, Mr. Burke. I have questions, but we will go ahead and get all the testimony.

Mr. Ellsworth, will you proceed.

STATEMENT OF ROBERT HATFIELD ELLSWORTH, R.H. ELLSWORTH, INC., NEW YORK, NY, AND MEMBER, ORIENTAL ART ADVISORY PANEL, INTERNAL REVENUE SERVICE

[The prepared statement begins at p. 151.]

Mr. ELLSWORTH. Ladies and gentlemen of the House, I am pleased to be here. Let me introduce myself. My name is Robert Hatfield Ellsworth. I have been a dealer in the oriental art field for over 35 years and have sold important works of art to almost every major museum in the United States.

I have written what is considered a definitive work on Chinese furniture and my reputation as an author rests on that. My reputation in the art world rests on the works of art in these museums. I contributed considerably to the oriental art collection of John D. Rockefeller III.

My position in the world of appraising was solidified when I did John Rockefeller's estate tax appraisal. This included 300 objects, and they were valued at $20,878,000. This is probably the largest oriental art collection to have passed through the IRS and the appraisal was accepted without a single adjustment.

This is probably one of the reasons I was chosen for the Panel.

Conflicts of interest, a question you gentlemen are interested in, have arisen during my term on the Panel but as far as I can see none seems to have caused any embarrassment so far to anyone, and I have been on the Panel since its inception. I accepted this position as I felt my combined experience could be of value. Over the years I have been conscious of abuses by those seeking tax shelters and appraisers who provide them with inflated appraisals. These were jeopardizing noncash charitable contributions. I felt it my duty to expend some energy to help prevent abuse and to preserve the charitable contributions.

The Far East Asian Panel spans many cultures that extend over thousands of years. For this reason this rather esoteric field is difficult to cover, even with five experts. However, I feel we are working very efficiently together. So far we have seen very few objects from estates so in this area I am not able to make any comment.

Inflated evaluations for deductions are the major problem for the Far East Asian Panel. I would like to give you a few illustrations of our effectiveness in this area.

For the year of 1985, the Far East Asian Panel has judged 84 percent of the items reviewed to be over valued and has reduced the total of these by 73 percent. I have to add that we are working on a large backlog as the Panel is new, and so we are taking care of current work as well as work that goes back many years.

We have been able to pinpoint a few appraisers who continually inflate evaluations and a few institutions that tend to accept overvalued gifts. We have also put a stop to one if not two tax shelter schemes.

The charm and muscle of our Panel has prevented any litigation so far. In fact, only a few days before the trial one case was settled totally to the IRS' satisfaction with no compromises.

Another problem concerned a group of objects valued at well in excess of $1 million. They were donated to a single museum by a large group of donors who threatened many separate lawsuits. This case at last seems to have been settled. The museum and the donors have stated they will accept without litigation the Panel's reduction of the total by 70 percent.

In another instance two separate groups of jades—Ms. Carolan did explain to you that some are not jades, they are actually soft stones—with a combined value of $779,900 were devalued by the Panel to $154,130. This reduction was 86 percent, with a savings to the public of $625,770.

With a slight tightening up of the law, the IRS valuation system could accomplish a great deal more I feel, if not almost totally eradicate the overevaluation problem. In 1985, with foresight, you gentlemen required the appraisers to be legally responsible for evaluations. You created form 8283 that the donor was required to complete and attach to his return. 8283 gives the name of the tax-exempt institution receiving the gift, the name of the appraiser, and the amount of the evaluation, if relevant, the cost price. The form requires a description of the gift, and that the form be signed by the curator or director receiving the gift, this making the tax-free institution aware of the amount of the evaluation that is being taken.

If you ladies and gentlemen would further require that a copy of this completed form for every gift in excess of $5,000 be sent to the valuations section of the IRS for its use, the IRS Panels could really bite as well as bark. These forms 8283 would create a data bank and would provide invaluable information and statistics in which you gentlemen seemed to be quite interested. For the first time we could know what percentage of charitable contributions was in the art field. We can have statistics on who was giving, who receiving and what.

Appraisers who consistently over-appraise could be pinpointed and notified that their appraisals were no longer acceptable to the IRS. We would know as well what appraisers produced consistently acceptable evaluations.

I would be here all morning if I were allowed to explain all of the benefits that I think the suggestion could produce. For example, a description of the given objects albeit brief, would enable the experts, or the Panelists to come to some judgment as to the validity of the gift. Let me illustrate a hypothetical situation and draw a picture for you of what immediate conclusions could be drawn from the information in 8283, if allowed to be sent to the evaluation department.

Native perception tells the average American scanning the classified ads for a 1982 second-hand pickup truck with 80,000 miles on it that it should be priced at approximately $1,500 to $3,000. If the asking price printed in the ad were $25,000 they would only come to the conclusion that a typographical error had been made. The experts on evaluation Panels have their specialized gut reactions. If the description on 8283 read a 12-inch high 19th century chinese blue vase, the proper range of values should be a few hundred dollars to perhaps $12,000. If the valuation claimed was $25,000, the 8283 would immediately be pulled for inquiry.

If the description were of a like object but dated 17th century, the range would be $30,000 to $35,000, described as 14th or 15th century it could run from $25,000 to a quarter of a million. If the valuation were on the high side of this range, the valuation section would immediately know whether the accepting institution were a plausible place for such a gift. If the appraiser's reputation were good, no bells would go off. If it seemed illogical further inquiry could be made.

A data bank with only a few years of 8283 forms would, I believe, greatly curtail if not eliminate the abuses that have been perpetrated on noncash charitable contributions. Currently less than 2 percent of the Nation's tax returns are reviewed. The tax-exempt institutions that have never been looked into are legion. Those who avail themselves of this tax provision and abuse it as well as those who do not would quickly become a statistic.

One last benefit from an overvalue of all of 8283 forms is that all taxpayers donating gifts could then be treated with equality.

I believe that if the Internal Evaluation Department is allowed this gift, the noncharitable contributions can remain part of our national tax structure and not of art from private owners to public collections continue for the benefit of us all.

Thank you very much.

Chairman PICKLE. Thank you, Mr. Ellsworth. Now we will hear from Mr. Nash. I am going to ask you gentlemen to limit your testimony to 5 minutes so that we may move forward.

STATEMENT OF DAVID J. NASH, DIRECTOR OF FINE ARTS, SOTHEBY, PARKE BERNET, INC., NEW YORK, NY

[The prepared statement begins at p. 155.]

Mr. NASH. Mr. Chairman, members of the committee, good morning. My name is David Nash, director of the Fine Arts Department of Sotheby.

Several of the items in my statement have already been covered by other members of the Panel, so I will limit them just to——

Chairman PICKLE. Your statement will be admitted.

Mr. NASH. I served on the IRS Art Advisory Panel for the last 2 years, and I have attended the past four sessions. When the IRS Advisory Panel was originally formed in 1968, I felt that the presence of an expert representative from the auction field was necessary, as the basis of reference for almost all evaluations discussed by the Panel is the published auction price, prices at which paintings are sold on the private market are seldom if ever public knowledge, and the IRS depends heavily on the information supplied or published by the leading international auction houses.

It was with great pleasure, therefore, that I accepted Ms. Carolan's invitation to join the Panel in 1984. My contribution to the Panel I think rests on my 25 years experience in selling and appraising valuable paintings at auctions.

In my view the Art Advisory Panel serves an extremely valuable function in its capacity to advise the IRS on valuations submitted by taxpayers. The Panel gives its recommendations on the accuracy and fairness of appraisals submitted and attempts with in my opinion considerable success to give orderly and professional advice to the IRS.

The statistics in the statement were covered earlier.

The benefit of the Art Advisory Panel to the arts community as a whole, I think, is extremely important. Several of the world's greatest museums are in the United States and American interests in the visual arts is enormous and is growing. I understand that the number of people visiting museums across the country now exceeds those people who attend sports games.

The object of their interest obviously is the works of art which are displayed by the museums, and it must be remembered that many of these museum collections have been formed quite recently.

The arts community has benefited from one of the most innovative and creative sources of supply of artworks in the world, the tax deductible donation. This system has enabled American museums to complete successfully with the other museums of Europe where no country has such a generous scheme for encouraging collectors to give important paintings to their Nation's museums in return for a tax concession.

The orderly maintenance of this inducement is greatly in the interest of the museum going public, and the existence of the IRS reviewing Panel ensures that the system remains free of abuse on the part of donors.

In my experience the reviewing process of the Art Advisory Panel has been very effective in enabling the IRS to curb and to reduce the overvaluation of charitable contributions and to appraise at their proper values works of art which have been underestimated for estate tax purposes.

In view of the fact that the Panelists do not know the name of the taxpayer nor the appraiser who has done the appraisal, nor the institution to which the donation has been made, it has not been possible for me to form any opinion about appraisers who are unreliable or institutions which bend over backward to accept property which is overvalued.

The process for reviewing the valuation of a work of art is similar in every respect to the disciplines employed in making original appraisals: namely, (1) is the painting or sculpture by the artist it is supposed to be by—is there any doubt about its authenticity; (2) is the medium and/or material correctly described; (3) is it an important work by the artist; (4) does its condition have an effect on the appraised value; (5) are the comparable sales prices cited by the appraiser accurate comparisons or are they carefully selected to provide a distorted figure; (6) is the work in question commercially attractive and desirable, or is its market limited?

In answer to the question of confidentiality, in the event that a painting or sculpture comes before the AAP which one of the Panelists has appraised, that Panelist must exempt himself from any discussion of its value and leave the room in order not to influence the fellow Panelists in their determination.

I think the one area we feel we could be given greater help is the quality of the photograph submitted and the amount of the information which is submitted by the taxpayer.

In my experience, the effectiveness of the AAP has become common knowledge to those submitting appraisals for estate tax or charitable deduction purposes and the abuses of the past are now quite rare.

I think that is the end of my statement.

Chairman PICKLE. Thank you.

Now we will ask Mr. Rosenberg to proceed.

STATEMENT OF ALEXANDRE P. ROSENBERG, PAUL ROSENBERG & CO., NEW YORK, NY

[The prepared statement begins at p. 157.]

Mr. ROSENBERG. Mr. Chairman and members of the committee, I am invited to present some remarks on the purpose, functioning and performance of the Art Advisory Panel of the Commissioner of the Internal Revenue Service as seen from the viewpoint of a Panelist and of a long-time professional member of the art community.

My name is Alexandre Rosenberg. I am a New York dealer in fine art, associated for the last 40 years with the firm of Paul Rosenberg & Co., the last 28 years as its sole director. The firm is a family business first established in Paris in 1878 by my grandfather.

I have served on the first Advisory Panel for 3⅓ years, starting in 1968, and I am currently serving a second term, which began in April 1985.

I believe that the Panel can be best understood by placing it in historical perspective. In the 1960's, due to the steady rise in art prices and the high rate of taxation, there appeared mounting evidence of widespread abuses in the form of overvaluation of donated works of art and, to some extent, also of undervaluation of works of art listed on estate tax returns, abuses attributable to ignorant or unscrupulous appraisers. The situation was sufficiently serious as to justify some alarm that, unless it was corrected, Congress might simply abolish the deductibility of art gifts.

It had been, indeed, one of the first major concerns of the newly formed Art Dealers Association of America, of which I was elected the first president in 1962, and for a second term in 1976, because some dealers were suspected of issuing inflated appraisals as an inducement to buyers or of yielding to the pressure of clients to obtain high valuations under explicit or implied threats of withdrawing their patronage.

In response, the association made it a condition of membership that members desist from appraising individually and that all appraisals be issued in the name of the association.

However, this act of self-policing could not correct the whole situation as many dealers were not admitted to the association or declined to join, and as a host of other appraisers were operating outside of the purview of the association.

It is at this point that a joint delegation of the Art Dealers Association and of the Association of Museum Directors went to the IRS in Washington to impress, one, that a mechanism for reviewing the appraisals was absolutely needed; two, that the IRS has no competence of its own in artistic matters and had no expectation of either training its own experts or hiring from the outside valid existing experts.

The solution advanced was the suggestion that an advisory Panel be created, of which the members, 10 or 12 in number, would serve voluntarily and without compensation for the public good, and which would be comprised in more or less equal parts of museum personnel—directors or curatorial level—art historians and dealers, and three classes in whose ranks the most likely qualified individuals could be found.

May I point out that as a result of the lack of expertise of the IRS in this field, some perfectly accurate appraisals were challenged for no good reason and honest donors unduly harassed, while appraisals two or three times higher than reality were accepted or merely trimmed down by a small percentage, generating a large measure of resentment and distrust. The Art Advisory Panel was instituted in 1968 and soon contributed to restore a more orderly state of affairs.

Having served then on the Panel and serving again now after a 14-year interval, I am in a position to measure how the management of the Panel has evolved. The beginnings had been sometimes difficult as could have been expected of untested procedures and of a permanent staff new to its duties. The material submitted to the Panelists was raw, with few information, and accompanied by photographs of very poor quality. The production of the necessary duplicates was at that time entrusted to one of the military facilities. Elaboration of the data required considerable independent research

on the part of the Panelists and frequently by a great effort of imagination and guess work.

Returning to the Panel last year, I was pleasantly surprised to find a dramatic improvement and so expressed after the working session of last April. The data submitted is now complete and to the point, the results of some initial research are supplied, as for instance the record of auction sales of comparable objects of art, and other various pieces of relevant and useful information. The quality of photographs is better, and a larger proportion is in color, although I shall have to come back to this question when I consider possible improvement.

More importantly, the staff has developed a surprisingly sophisticated understanding of the workings of the art world, private dealing, auction sales, methods of museum acquisitions, as well as familiarity with the reputations and singularities of a great many of the personalities making up the American art scene. This is especially important regarding appraisers who, I feel, have been by how fairly graded in terms of their reliability. A library has been assembled.

Last, there is seldom in the packages prepared for the study of the Panelists cases unworthy of scrutiny. All these points result in a greater economy of time, better efficiency, and much smoother functioning.

I will skip the part of my statement that has been covered by previous speakers.

On the side of the Panel itself, as distinguished from the permanent administrative staff which runs it, it is clear that the Panel cannot be better than the Panelists who compose it. So far, I believe that the recruiting has been consistently well advised.

The qualifications required from a Panelist are twofold. He or she must be knowledgeable and experienced, preferably a long experience, in definite fields of art. True experts are necessarily specialized as art is much too vast and complex a world for any one person to know it all. There is no such being as an "art expert;" only experts in certain forms or periods of art. Any claim to the contrary should be ignored.

As a result, the Panel should be made of a blend of various experts representative in their diversity of the balance of the categories of art coming up for review. To avoid an excessive fragmentation, however, and to ensure that more than one Panelist can act on each work of art under examination, experts with too narrow a focus of knowledge should be avoided and those with a reasonably wide field of experience preferred.

The second qualification is that he or she be impartial. Fortunately, conflict of interest is almost never a serious problem as nobody has really anything to gain or lose personally by appraising for the Panel.

Is this system capable of improvement? In itself, the process of appraisal cannot be different in kind. It can only vary in quality. The principal consideration is to keep the caliber of the Panelists as high as possible, and it can be kept very high from the existing national resources.

Most of the other practical improvements have been brought in effectively by the new regulations that became effective this year.

They include a tightening of the definition of "appraiser" under which no longer can anyone call himself or herself by that name just by saying so. Instead, some credentials are to be produced. In addition, possible prosecution is provided for fraudulent or conspirational appraisals, and plain disqualification in case of habitual errors, even in good faith. This should decrease the instances of abuse and drive away incompetent appraisers.

Second, the responsibility of the institutions which are recipients of donations is engaged by having to sign the acceptance of the donated object as described on the donation form. This should reduce the cases where a museum accepts unworthy material for political reason or accommodation of the donor: It has now to state in effect that the object given enters its permanent collection, not just become buried forever in the basement.

Third, fines and other penalties are set on the donor for too large discrepancies between appraised value and real value.

Finally, appraisers who may have been personally connected with recent sales of the donated object, especially sale to the donor, or who are associated with the recipient institution, are barred from appraising. This eliminates an important source of conflict of interests. All these improvements are well-advised and welcome, and come close to fulfill what can be done in this domain. They are, however, too recent to have already borne fruit.

It leaves the question of the most important tool which the Panelists use in their task: the photograph attached by the donor to his or her tax return. I must say that in many cases the quality is sorely deficient and therefore confers to the system a weakness which cannot be completely overcome, regardless of the virtuosity of the Panelist. It is the most probable cause of any misjudgment. Too often, donors supply a blurred snapshot of the object, by instance of a painting hanging on a wall and taken at an oblique angle to avoid the glare of the flash. It may even be sometimes intentional.

Deciding on this basis if a work is an original and what are its exact quality and state of preservation can be a rather acrobatic feat of mind. When thousands of dollars are claimed in deduction by donors, it may not be immoderate to impose on them the expense of a large photograph of professional quality, possibly in the form of a color transparency, which would probably by deductible in any event, or else disallow the deduction.

Chairman PICKLE. Have you completed? Let me suggest we go on and come back for any additional statements you may make. Your entire statement will be made a part of the record. I like your testimony. I wish we had a little more time. We will try to come back to you. Now, Mr. Sieber, if you will proceed.

STATEMENT OF ROY SIEBER, ASSOCIATE DIRECTOR FOR COLLECTIONS AND RESEARCH, NATIONAL MUSEUM OF AFRICAN ART, SMITHSONIAN INSTITUTION, WASHINGTON, DC, AND RUDY PROFESSOR OF FINE ARTS, INDIANA UNIVERSITY

[The prepared statement begins at p. 164.]

Mr. SIEBER. I am an art historian. I work both at the Museum of African Art, which is part of the Smithsonian, and Indiana Univer-

sity. I have been on the Art Advisory Panel as a specialist in African art since June 1984 when the African, Oceanic, pre-Columbian, and Indonesian section of that Panel was established.

In my view, the Panel is functioning efficiently and usefully, carefully reviewing a large number of donations, and I think quite effectively.

I would endorse what most of the other Panelists have said on that point. There are, or have come to our attention, instances of significant overvaluation, much more frequent in my section than undervaluations. In other words, undervaluations are rarer, although they occasionally appear, because there are fewer pieces that form part of estates at this point.

I think that the Panel which was only expanded in 1984 to include African, Oceanic, and so on, has probably not been in existence long enough to give a full evaluation of its effectiveness. At the same time, discussions with concerned public lead me to believe an impact has been made, and that future donations will be more cautiously and realistically valued.

In 1984 and 1985, the primitive and pre-Columbian area reviewed almost 1,500 artworks with a total claimed value of over $11 million; recommended adjustments for average overvaluation on each overvalued item was 1,959 percent overvaluation for 1984, and 571 percent for 1985. I think that is just a variance that can occur from one year to another. There is certainly no way in which the first year's overvaluation could have affected the second year's donations, because we were far behind in our review at that point.

I believe in the areas of African, Oceanic, pre-Columbian and Indonesian, the cases that have been reviewed, represent the tip of the iceberg. There is a great deal more that has gone on, and indeed I feel that one recommendation that I have is that the $20,000 valuation level for mandatory screening by the Panel should, in the case of the primitive and pre-Columbian objects, be reduced, simply because in my observation of the objects referred to the Panel, the greatest overvaluation of, for example, African art objects, exists in the $5,000 to $20,000 range.

So that perhaps Mr. Ellsworth's suggestion that all $5,000 and above declarations which now have to be submitted by the taxpayer could go directly to the Panel. This would, I suspect, mean the staff of IRS dealing with art donations would need to be supplemented so a larger cross-section of donations could be reviewed.

In short, I believe that my section of the Panel which has existed only since 1984, needs to be continued before objective assessment of its effectiveness can be made.

I have one final rather brief point to make, and that was the question about courts. The question was: Do you feel the IRS can hold its own in the courts against the high-powered attorney of the taxpayer? Do the judges recognize the IRS position on valuations, or do they tend merely to split the difference?

In my one experience with a tax trial—and I was one of the IRS's expert witnesses in the Nealy trial, which was described earlier—I found that the IRS held its own very well, that the judge was most attentive to the Internal Revenue's lawyer, and that the

judge did not split the difference. The taxpayer's valuation was over $1.5 million, and the IRS valuation was just under $168,000, and he accepted the IRS's valuation.

This was a particular case, however, in which an unusually large percentage of tourist pieces and copies were presented as if they were genuine works of art. One of the major concerns in the area of the Panel in which I work is the importance of determining fakes, forgeries, and in the case of African and Oceanic art, modern copies which tend to be offered as if they were traditional form of art.

Thank you.

Chairman PICKLE. Thank you.

We thank all of you gentlemen.

One question that I was going to ask seems to be touched on by most of you witnesses, and that is you need the best photographic equipment possible, and that more improvement needs to be made in this area.

Now, how can we do that? As I understand it, if a piece of art is to be evaluated by the Panel, or reviewed, you receive a copy of that object and you make your appraisal partially based on that photograph.

Who produces the photograph? The person who is claiming it, or the regional office? Is it left up to the individual? If that is so, isn't the quality sometimes weak, or should it not be better quality?

How could we have better photograph requirements? How do we go about—what could the Internal Revenue require that we do?

Who would want to touch on the subject of the photographs? Mr. Rosenberg?

Mr. ROSENBERG. The donor should be put under obligation of supplying with his return photographs meeting certain standards of size, of quality, and so on. It should be an 8 by 10 photograph, 8 by 10 inches.

Chairman PICKLE. Is it required now to be an 8 by 10?

Mr. ROSENBERG. No. I think this is left to the discretion, and some donors just provide a snapshot that they do themselves, which is a very poor basis for judgment. And I don't think that would be an excessive burden on taxpayers to demand their photograph meet certain technical standards.

The problem is not the duplication, the later duplication to Panelists. Duplications can be made without any loss of quality. It is the initial photograph of the donor that is deficient.

Chairman PICKLE. Do the Panelists generally agree on that approach?

Mr. BURKE. Absolutely.

Chairman PICKLE. Does the Internal Revenue Service—the Art Panel—do they need more staff, more personnel? They did not testify they did this morning. They thought they were handling it.

But it seems to me like—I have to ask you since you meet only once or twice a year for review, it raises the question: Is it often enough? Is it a large enough staff? Do they have funds to go into the various regions of the country where this object is being reviewed?

Mr. SIEBER. In my area, I think it is quite possible. As I suggested, we are only seeing the tip of the iceberg in the sorts of things

that should be reviewed by the Panel, because so many of the objects fall between the $5,000 to $20,000 evaluation range, and there are a good deal of false or inflated evaluations taking place in that range. But if that were to be reviewed more closely, I think you probably would need a supplement to the staff.

Chairman PICKLE. Well, in that connection, do you feel the Internal Revenue Service has adequate presence and enforcement tools in this particular area, or is more needed?

Mr. SIEBER. In my estimation, the tools are there, are present. I mean, they have what they need. The effectiveness I think lies in the closer screening of the objects.

Chairman PICKLE. I notice you recommend the $20,000 level be lowered to, say, $5,000.

Mr. SIEBER. I wouldn't mean to speak for the other area of the Panel, the Painting Section, and so forth.

Chairman PICKLE. What does the Panel think about lowering the figure to $5,000? Is that desirable?

Mr. ELLSWORTH. I think on the Oriental Panel, it is desirable.

Chairman PICKLE. I didn't understand you.

Mr. ELLSWORTH. In the Far Eastern Section, I think it is desirable to lower it to $5,000, yes.

Mr. BURKE. It would seem to me if the limit were lowered, IRS would need more staff to handle a greater caseload.

Chairman PICKLE. I think that would follow, too.

Well, I think your testimony is very helpful.

Do you feel that—Mr. Ellsworth, you had made the recommendation, and I asked the Commissioner earlier that form 8283, I believe it is, be sent directly to the Art Valuation Section, and you stated also it be signed by the curator——

Mr. ELLSWORTH. That form is signed automatically by the curator or director of a museum, and it is returned to the taxpayer.

What I suggested was a copy of it be sent by the accepting institution to the valuation department. Then you would have the answers to what you were asking all morning as to what percentage of the charitable deduction is actually in art and where the rest of it is. Those standards would come up, and we would be able to, with—I don't think very much help, but certainly a computer—be able to build the valuation system; we would be able to build a data bank that would immediately include them as to the quality of the donee, the donor, the appraiser, et cetera.

Chairman PICKLE. We did not get an answer from the Commissioner about whether they would approve of that, but they at least indicated they had taken it into consideration, that that might be a stepped up improvement on it.

Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

I would like to express our appreciation to the Panel for their work. I am concerned that we do not go too far. It seems to me that when we encourage the contribution of art and artifacts to museums we give the public the opportunity to see and appreciate these objects. However, if we slant the Tax Code to the advantage of the individual to keep art in his possession, we bar the public from having the opportunity to enjoy it. Although most of the individuals or workers in my district cannot afford to buy hundred-thou-

sand, or multi-million dollar paintings, they certainly do enjoy the opportunity to view those paintings in a variety of museums.

I will be brief, with just one question or two for the Panel. It must be a job keeping up with current valuations. How do you do that? How do you know the value of an object? An object may have been purchased for several thousand dollars a few years ago, but may be very much in demand and the price could skyrocket. How do you keep abreast of the current valuations of such objects?

Who would like to answer my question?

Mr. Burke.

Mr. BURKE. I will speak for myself to say that one follows the auction sales, both in New York and in other parts of the world, where there are published records of prices and things. I follow the auction sales in our region; for instance, Chicago or St. Louis, estate auctions, things like that.

Our staff people do, too. We try to visit the art dealers and art galleries, whether they are large or small, in our own region; and in the national markets, whether that might be in Houston or Los Angeles or New York, or someplace else.

I am going to some art galleries and just looking at pictures and sculptures and things, and seeing what some people are going to ask for them. One also hears from colleagues in the other museums, what they pay for things, hear from collectors or individuals, what they pay for things. Whether that is somebody buying something as modest as a Peterson bird lithograph or somebody who has spent a million dollars on a Monet, through one's own circle of friends, professional acquaintances, one builds up a fairly large bank of information.

It is pretty hard to cover the whole real estate from, as I said earlier, cave painting to present day. But at least it is possible for us to keep a grasp on major areas. And it seems to me that the Panel divides itself amongst experts who know each one of the general areas of art.

I follow the old Master paintings and American paintings very closely, but am not very good on African art.

Mr. SCHULZE. Are prices set, determined, or influenced by those who buy from museums?

Mr. BURKE. I think museum buyers are a very small part of what the national or international art market is. I think we should let Mr. Nash answer that, because he knows who buys things more than we.

But I would bet you museums in this country are less than 5 percent of the total transacted value, and most of it was frankly individuals buying things, whatever those things were.

Mr. NASH. I would back up that statement. Museums represent a very small percentage of the purchases of paintings and works of art that we sell. In fact, I can give you a number of instances where the richest museum in the world has actually been outbid by private individual collectors or by dealers. So, museums—the influence museum-buying has on establishing a scale of values is really quite small.

Mr. SCHULZE. You do feel, then, perfectly capable of staying abreast; of and not behind the market? You are current at all times with market——

Mr. NASH. For myself, that is my daily job, to keep abreast of the market.

Mr. SCHULZE. I thank you. I again express our appreciation for the work that you do.

Chairman PICKLE. Mr. Frenzel.

Mr. FRENZEL. Thank you, Mr. Chairman.

Gentlemen of the Panel, with the chairman and the distinguished ranking member, I want to thank you for your testimony and for your service on these Panels.

How long do you serve on the Panel? Is it a term of 1 year?

Mr. ELLSWORTH. Two terms of 1 year, two single terms of 1 year each consecutive, and then we change.

Mr. FRENZEL. When you go off the Panel, can you be invited back after a break in service?

Mr. ELLSWORTH. Yes, after a length of time.

Chairman PICKLE. Should those terms be longer?

Mr. ELLSWORTH. I believe they should be, especially in the oriental field, where generalists are very hard to find. You have an Indian painting specialist, he can't tell you very much about Southeast Asian decorative arts or South Indian bronzes, and to get a generalist like Dr. Sherman Lee to cover the entire field and be helpful in many ways, if he were willing to stay on for 4 years and donate his time, he should be allowed to. We are not a paid Panel, so there is no conflict there. In the painting world, there may be a great deal more experts around, but I think it is going to be very difficult to change the Far Eastern Panel every 2 years.

Mr. FRENZEL. Thank you.

Is there any prestige to serving on the Panels, or is it just work?

Mr. ROSENBERG. I am afraid not, not whatsoever. The name of the Panelists is not publicized, very few people are aware of who is serving. I don't think there is any aspect of prestige involved.

Mr. FRENZEL. Thank you. There have been a number of suggestions, first, to extend the 8282 forms from the donee to the Art Section of the IRS, second to insist on high-quality pictures and presumably hold up the report until a good picture is received, and third to lower the amount of contribution that triggers immediate reference from $20,000 to $5,000, at least for African and oriental art.

Would some of you who work in other areas suggest that we lower that figure, as well, to $5,000, assuming that you have adequate resources?

Mr. ROSENBERG. Yes, I think we would cut that down by about half. But we have to keep in mind that the lower price range will bring in very numerous objects, the most numerous objects are the ones of low value.

Mr. SCHULZE. Will the gentleman yield?

My understanding is that the $20,000 figure is administratively decided upon by the IRS and that the IRS is free to lower that figure if and when it feels that it would be advantageous. I don't know whether that is an area in which we should necessarily make a judgment without a little bit more information. After all, the whole concept is relatively new. I would guess after the study that the IRS is having done, we might look at that, but it is an administrative decision.

Mr. FRENZEL. Mr. Chairman, I was about to request that the Chair ask Commissioner Owens and his group to respond to these suggestions and others, which perhaps I don't remember, to determine which of them can be done administratively and which of them would require a change in law and to indicate which they thought had merit. I am sure we could keep the committee record open for those responses. I yield the balance of my time.

Chairman PICKLE. Mr. Frenzel, I think your suggestion or requests are good ones, and they will be forwarded to the Commissioner, and we will be submitting other questions we didn't have time this morning for response. I think that suggestion is a good one.

Gentlemen, let me ask you two or three questions. Since you have been serving on the Panels, have you been shocked or disappointed to the extent and magnitude of the overvaluation of donated art work?

Mr. BURKE. I would say my experience on the tax shelter cases was certainly in that category. I was horrified at the amount of abuse going on, and the statistics that the Commissioner gave earlier I think were a very good indication of it. When the thing started up, I had no idea the extent of abuse was so great as that. We went through what seemed to me like hundreds and hundreds and hundreds of cases in which there were just wild claims of value that couldn't be substantiated at all, as I said in my testimony, furthermore, things that didn't have any social utility to them. It was just in my mind a terrible ripoff, and I was very pleased that I went to the meetings because I felt as a taxpayer myself that I had something to say.

Chairman PICKLE. Has there been any follow-through on your part as a Panel by making recommendations that might be a fraudulent claim, or do you just say "We are not going to allow it," and you make a factual finding rather than recommendations? Is that what you do, disallow, so to speak?

Mr. BURKE. That was basically it in the case of the tax sheltered situations. IRS moved very, in my mind anyway, very expeditiously to meet the problem and to deal with it very well. There were a number of cases that went to Tax Court trials.

Chairman PICKLE. Since the creation of the Art Advisory Panel and the Art Valuation Section, have many of these abuses been lowered? Is the practice getting much smaller?

Mr. BURKE. I think it has, frankly. If I think back to the early 1970's, the late 1960's, when the Art Panel was first put up, it was common to hear donors talk about taking a piece of art and putting a high price in it and seeing if they could get away with it. One doesn't hear that any more. One still sees a certain amount of overvaluation, and, as I say, maybe 25 percent of what one sees seems to me to be quite wrong. But I think the system is having its effect after 15 years or so, 17 years, to clean itself up, and as things have gone along, it seems to me the IRS staff has gotten more sophisticated about this. They have gotten more efficient about the way they handle these kinds of claims. The Panels have become more knowledgeable.

Chairman PICKLE. Have you, as members of the Panels, discovered through the work of the Art Advisory Panel that certain ap-

praisers consistently provide overvaluation to the taxpayers or that certain museums tend to be recipients of art contributions that are overvalued? Is there a pattern to that?

Mr. BURKE. We don't see the name of the appraisers.

Chairman PICKLE. You do not?

Mr. BURKE. Until we get to the 1985 returns, we won't see those names in that data coming up as the new law would have provided.

But to add a personal note, going back to those tax shelter cases, we did see the names of the appraisers, and frankly if the Government had disbarred about 10 or 15 appraisers, they could have thrown the whole thing down much earlier. So I think that will be potentially a very effective mechanism.

Chairman PICKLE. I think, Mr. Sieber, you commented on the question that the Internal Revenue Service has been able to hold its own in the court in these cases that have been contested. Does the Panel generally feel the Internal Revenue Service has been doing a good job in these valuation cases?

Mr. ELLSWORTH. I think so.

Mr. ROSENBERG. I think so, too.

Chairman PICKLE. I wish you gentlemen would do this for us. We think the Panel is extremely helpful to the Internal Revenue Service. If you have a specific suggestion, we would like to have it to make an evaluation of our own here as a committee, and as we move along, if you have other recommendations, we would like to hear from you because more needs to be done in the area of these quick evaluations.

I certainly think there should be a requirement of an 8 by 10 photograph of high quality. I don't see how you can make an evaluation with a little snapshot or something. I think personally, it seems to me like you ought to send a copy of that to the director, Mr. Wells, of the Art Valuation Section. And then everybody is on notice that they are going to be reviewed, not just that they might by chance be part of that 1 or 2 percent, but that somebody is looking at all of these. I think that would have a very strong effect toward honesty and practicality.

I think your testimony has been helpful to us. I thank you for it. We appreciate your presence here today and your testimony. Thank you.

Our last Panel consists of Sheldon Cohen and Peter Marzio. As we all know, Mr. Cohen is the former IRS Commissioner, and he represents the firm of Morgan, Lewis & Bockius here in Washington. Mr. Peter Marzio is director of the Museum of Fine Arts of Houston, TX. We are glad to have you gentlemen.

Mr. Cohen, if you will proceed, we will be pleased to have your testimony.

STATEMENT OF SHELDON S. COHEN, ESQ., FORMER COMMISSIONER OF INTERNAL REVENUE

Mr. COHEN. Mr. Chairman, Mr. Schulze, I am pleased to be here at your invitation this morning in my individual capacity. As you may recall, I had the privilege of being at the Revenue Service when the Art Panel was created. I have clients which are museums, for example the Smithsonian Institution, and I also represent

donors. Today I will try to represent myself and not any of those institutions.

The problem of dealing with appraisals of gifts has been a serious problem for a long time. It has been a serious problem both to the IRS and, as you have heard this morning, to the art world. De Tocqueville commented on our system of organizing charities and institutions to resolve problems in this country. That system generated by the gift of appreciated property, particularly to the museum and art world, has been of a tremendous assistance and makes our system unique in the world.

A number of years ago, I was invited to a conference in England to discuss this system so as to draw distinctions between the English system and our system. I can tell you from my discussions with the English and from my discussions with other persons involved in the art, museum world, on the continent, that our system is the envy of all of those systems.

And so it was important to the responsible people in the museum and art world in the 1960's, as we began to recognize the problem of abuses of valuation and as they began to recognize if those abuses kept up and the IRS did not have the capacity to deal with them that the deduction would ultimately be withdrawn by the Congress. The Congress was then discussing a number of ideas along those lines.

And so it was that Dr. Sherman Lee, who was then the director of the Cleveland Museum, and who was also the president of one of the major associations of museums in the United States, with his counsel, came to visit me one day. During the course of that discussion the idea of an Art Panel was evolved. We discussed exposing to the members the raw data, without the identification of the parties. Interestingly, as a by-product, the members of the group were so expert that generally they knew the individuals, and they knew the representative institutions also.

The object at the time, at the beginning, was merely to place the valuations in ballparks, that is it was really within the ballpark or it was way outside. Then the Service was to go out and find qualified appraisers. The art group also agreed that since qualified appraisers in many of the esoteric types of gifts were hard to find, they would help us in finding those qualified appraisers.

At the first meeting the members of the group were so outraged by what they saw that by the second meeting they volunteered quite often to appraise or to get an appraiser for the Service. So evolved the idea which has since flourished of the group itself providing appraisals.

Some of the ideas that have been discussed here today are very good, if this were the only problem facing the Internal Revenue Service. Of course it is not. It is not the only abuse that the Revenue Service faces either. They could use a lot more staff in some of the areas that are dealing with these valuation meetings.

On the other hand, the IRS is giving a lot of attention to the area now. If they received, for example, every form on every gift, the question would be what could they do with it. They do not have the manpower to audit all those returns anyway, nor do they have the time. You can use these expert folks for 2 or 3 or 4 days a year. Under those circumstances, they will volunteer their time. Howev-

er, if you called them for 2, 3, or 4 weeks a year they would not volunteer their time and I wouldn't blame them. So you cannot abuse that very valuable resource that you call upon and therefore you have to restrict your cases to the most abusive cases.

That is not to say there shouldn't be other folks in the valuation group at IRS with Ms. Carolan's expertise. They could glean out from this huge pile of material the worst cases that deserve the careful detailed look.

It is my observation as a sometime participant in this practice that over the last 16–17 years that this area of valuation is better. You do not hear the outrageous stories, you don't see people going to a gallery and obtaining a purchase with an appraisal of three times or four times the value dated a year from today and stuck in their pockets. That used to happen. That was not at all an unusual event 15 or 20 years ago.

So it is hard to evaluate what is happening in terms of statistical data.

Those of us in practice can see it, and we can understand what our clients tell us. We are dealing with an area of human nature. The evaluation of a gift of art is no more or less scientific than the valuation of a piece of land. Land appraisal has gotten down to fairly scientific proportions, and yet a piece of land will sometimes jump quantum leaps over a comparably situated piece of land two or three blocks away or a half a block away, because of a particular need. So valuation is really a question of touch, feel and sense, very much like the art world is.

A drawing by a particular artist may be one of his best or one of his worst, and just because the best one sold for a huge price last week doesn't mean that the next one, which happens to be a pretty sloppy thing, will sell for anywhere near that.

You can understand an optimistic donor, however, trying to take advantage of the highest range in price. So it is with land.

The advantage of the art appraisal group in the Service is that they would look at both the gifts for charitable purposes and the gifts for estate purposes, and in our day they never knew which they were looking at. They never knew whether the person we were dealing with was a decedent and therefore his executor tried to depress the value, or we were dealing with a donor to an art institution and he was trying to inflate the value. That tended to keep objectivity. The group tried to call them right down the middle.

One of our problems in those days with the Art Dealers Association, I do not know if this is so today, is the Art Dealers Association was good in dealing in the appraisal of art given as a charitable donation. In those days their rules forbade them from dealing with art that was included in an estate, and that tended to skew their objectivity, that is since they were dealers they tended to want high values.

Since contribution advantage comes in high value the Dealer Association values were skewed that way, and they stayed away from the area of estates; because the donor there wanted low values. I hope that has changed but I do not know that that is the case.

That concludes my statement, Mr. Schulze.

Mr. SCHULZE. Thank you.

Mr. Marzio, would you like to proceed.

STATEMENT OF PETER MARZIO, DIRECTOR, MUSEUM OF FINE ARTS, HOUSTON, TX, ON BEHALF OF THE AMERICAN ASSOCIATION OF MUSEUMS AND AMERICAN ARTS ALLIANCE

[The prepared statement begins at p. 169.]

Mr. MARZIO. Congressman Schulze, virtually all the points in my testimony have been made by a number of people already, and in the interest of time, if you would like, I could just list those basic points, and then, if you want me to elaborate, I will be more than happy to.

Mr. SCHULZE. Fine.

Mr. MARZIO. First of all, I want to thank you for asking me to come on behalf of the American Association of Museums and the American Arts Alliance. As I said, my brief testimony is 5 pages, and it will be submitted for the record.

It breaks down really into four or five points. First of all, I think the new law which took effect January 1, 1985, is viewed by the art field as an excellent step in the right direction. The idea of establishing high penalties for cheating, and second, requiring strict substantiation for claims are obvious and are probably long overdue.

In fact, the AAM and the AAMD, that is, the Association of Art Museum Directors, together produced this booklet once the law was enacted, and this booklet is a very clear presentation of what the law says about giving works of art. I am not a trained lawyer at all, and even I could make my way through it. I think most of our donors have felt the same way.

The booklet has been circulated to every major museum and related institution in the country, and I know that at the Art Museum in Houston, TX, every trustee and major donor has received a copy of this booklet.

My point in mentioning this is that I think you will find the museum profession is doing all it can to make the law known and to eliminate any gray areas.

The question is are these new laws working? Unfortunately the data just isn't there, and I know if I could wish for anything from the IRS in the next year or so, I would like to know that there was some way to do a testing to see if there seems to be a significant difference in the evaluation levels and the numbers of claims.

There is also a flip side to that, and when your committee holds hearings in the future, once the data is found, I would hope that you would invite representatives from the American Museum Association and AAMD in order to learn from them if the law has in any way negatively affected giving to museums. That may not be the case, but it should be determined whether there is any relationship.

In terms of broad policies, there are two points, and then I will end.

From time to time we hear that perhaps the donee should be involved in the evaluation process. I think that would be a serious mistake. I think separation of donor, evaluator, and donee is what is making the system as clean as it is becoming.

Finally, my last point refers to an earlier point, and I agree totally with Mr. Cohen. In the last 100 years or so in American cultural life, museums have skyrocketed. At this point in time, American art museums are the envy of the world. What they have done in a century is almost beyond imagination. That is due to two reasons in my opinion.

One, American voluntarism and American sense of unpaid cooperation is simply the American style of getting things done, and the second point is that private philanthropy, which is being driven by the Tax Code, or at least helped by the Tax Code, is an American invention. However, nobody who wants the invention to succeed wants to condone cheaters.

All I am asking for is for the Congress to be extremely sensitive not to disrupt this very, very valuable asset in our cultural life.

Thank you.

Mr. SCHULZE. Thank you, Mr. Marzio.

I agree especially with your latter comments, and that if we do have succeeding hearings we certainly should get the opinions you have recommended.

Mr. Cohen, were you concerned or alarmed to hear the statistics presented that show a continued problem with overevaluation, or do you just think this is human nature and it is going to go on and on?

Mr. COHEN. I am constantly disturbed and alarmed. As you recall, a month or so ago I appeared before this subcommittee to request that there be greater budget for the IRS. I did so because the audit level is the lowest I have known since I started practicing tax law. It is one quarter of what it was when I was in office, and I was striving for 5 percent.

It was slightly over four when I left IRS. I thought 5 percent was a good goal at that time. Now we have slipped off to where it is about 1.2. The general audit level is woefully inadequate.

The abuse in the art area is dramatic, of course, when it occurs. I think we are better off today than we were 17 or 18 years ago. That is not, however, good enough. Hopefully the 1984 penalties, when they begin to bite, will have an effect. I have had people call me up and say "Can I do this, can I do that." They ask silly questions, and the answer is no, you cannot do that. They did not ask those questions before. Now, with the appraisal forms, they at least ask.

Mr. SCHULZE. When you worked on the Panel, and determined or discussed the level of valuation which would bring attention, did you think about the future, and say eventually we will move that up or down, or wasn't that a given——

Mr. COHEN. That wasn't a problem, of course. When you do it the first time you are dipping your toe in and you are seeing how hot or cold the water is. The one big concern we had is that we had this terrific pool of talent that we were going to have for 2 days several times a year. We wanted to make the most efficient use of them, because we wanted them to enjoy the experience. We wanted our consultants to understand that their help was helpful to us. We didn't want to abuse their time, because this was a pool of talent which you could not have bought for hundreds of thousands of dollars a year. If we put too big a workload on them, or to deal with

more minuscule things than they thought were important it would have had a bad effect on the whole operation.

We were trying to get into this to show the Congress that responsible people could deal with it responsibly. Also, to show the museum, the art world, the dealers and just the general public that a responsible group could bring sanity to the valuation area. That was the way the numbers were chosen. I am sure the numbers are chosen today on a similar basis. Now I understand every $20,000 or up item goes to the Panel and to the IRS's professional Panel for screening at least.

If the capacity of the group and its interest is wide enough, one could drop the dollar guidelines. But once you begin to drop it, the numbers go up not arithmetically but geometrically. Therefore you will have a difficult time increasing the value.

I would rather have the group wanting more than be so satiated that they don't want to come back to the next meeting.

Mr. SCHULZE. There are experts on the staff, are there not, varying degrees of experts?

Mr. COHEN. I have to say to you that the first person I had in charge of this group was an engineer. He was an expert in evaluation concepts, but he was an amateur art lover. I used to meet him on Sunday when I would take my children to one of the galleries. His name was Carl Ruhe, unfortunately since deceased.

We now have in the Revenue Service professionals who have professional training in addition to the desire to want to learn.

Mr. SCHULZE. So they do make a great contribution as well, and are able to make reasonable evaluations in some of these other areas?

Mr. COHEN. That is right.

We couldn't rely on these 25 people because of the volume of work and you would bog them down losing time from their regular occupations.

Mr. SCHULZE. Thank you, Mr. Chairman.

Mr. Marzio, would you give me a rough profile of your average donor. In most instances do you have money with which to go out and buy art, or do you sell existing art to buy other art?

Mr. MARZIO. Curiously, in our museum in Houston, TX, about 82 to 83 percent of the things that are in the museum came as donations, that is the objects. I think that is close to the national average, if I am not mistaken.

That and many great things come into the museum that way. It is not unusual, however, among the larger museums like the ones in Houston, Dallas, and elsewhere, for the professional staff to find a great work of art on the market, and then to go after cash donations for that.

If we cannot get the money for the work of art, we try to encourage a donor in our community or a wealthy person in our community to purchase it for themselves, and then we just keep hoping we gave gotten a little closer anyway, and maybe eventually it will come into the building.

Mr. SCHULZE. In your opinion are the tax aspects the primary driving motivation? I guess what I am trying to do is to determine how important the tax aspects are as well as the civic aspects such as the pride of ownership, contributing to society and so forth.

How would you evaluate the motivations?

Mr. MARZIO. I think it is for many people who contribute works of art. It would be a good study by the way, and I think that is a very good question. I think there are many people who collect art who are not the top, top wealthy people in the country, for whom literally it hurts financially. I mean they have to strain in order to buy a major work of art, and collecting is one of those things where once you start it you almost cannot stop. It is just human nature.

If the Tax Code did not exist, you would find—let's just use 50 percent, you would probably reduce gifts by 50 percent, not because those people were just money hungry. It is that they couldn't afford to give the gift away. And 50 percent may even be too high. It might be reduced to 30 percent.

The tax is very, very strong. Whenever a major gift comes into a museum, even by very wealthy people, very sophisticated lawyers, they want to sit down to talk about the tax meaning of it.

Mr. COHEN. Mr. Schulze, if I can volunteer, since I deal with the tax side of it more generally, although I am a trustee of some institutions that are receiving, taxes generally, for the better collections, are not the driving force. Most of these people are genuinely interested in art, and they are interested in the ego satisfaction of having the major gallery in their city accept a donation from them. Major galleries won't take just anything.

Mr. SCHULZE. Thank you.

Thank you, Mr. Chairman.

Chairman PICKLE. I want to thank both of you gentlemen for your testimony.

Mr. Marzio, I particularly regret that I was not in the room for all your testimony. I do recognize though that you are concerned about whether the oversight hearing at this point might be premature, until we have more information about how the proposed provisions, the penalty provisions work out.

I recognize that we will have to wait until we get more data. I also hope though that we don't have to wait 2 or 3 years to assemble that. If we are 2 or 3 years behind in the reviews now, there is reason to say that we ought to step up the procedure, the timeliness of it.

Would you agree with that in general?

Mr. MARZIO. Yes, in fact I had mentioned that if I could have one gift right now from the IRS, I would love to at least see them do a sampling of this new law to get some idea of whether there is any obvious difference between pre-1985 and post-1985.

Mr. COHEN. Mr. Pickle, as a practical matter I would second what Mr. Owens told you this morning, however. Those returns are only beginning to be audited now, and unless you were to tell the IRS to drop everything else and only look at artworks, there is no way to get adequate data in less than 2 years.

Chairman PICKLE. I do not intend to suggest that they just limit that to art work. I think it ought to be in all three categories or as broad as they would want to make it, but to step up the reviews perhaps even in larger numbers, and certainly in a faster manner would be helpful, so we really would not.

Mr. Marzio, are the contributions you received in Houston primarily Southwestern art? Are they international art, national art? Is it a good mixture?

Mr. MARZIO. It is an encyclopedic museum. It always surprises people, because when they walk into our institution, the strongest part of our European art collection is a really world class Italian Renaissance painting collection, which a family in Houston in the 1940's put together with some of the best advice in Europe that was available, and our second strongest collection is late 19th century French impressionism, and the third is our great collection of American decorative arts which Ms. Ima Hogg put together.

Chairman PICKLE. Is the Dallas museum similarly collecting well-known paintings or art work?

Mr. MARZIO. Yes, the Dallas museum is now in its new building. It is just one of the great U.S. museums, and when you look at their collection, once again people are often surprised, but it is not southwestern art. They are very, very strong in pre-Colombian and other forms of tribal arts, and that might be unexpected as well.

Chairman PICKLE. Do the museums in general find that the rules we have laid down to the Art Advisory Panel and the Art Valuation Section are workable and acceptable and do they participate, and if so, would they recommend the procedure we are following now?

Mr. MARZIO. Yes. The profession is very enthusiastic, and in fact it was the various museum professions that put together this summary of the law affecting giving of works of art, and it has been a widely circulated document.

I think you will find the profession enormously cooperative, and will try to do whatever you ask it to do, because they are convinced that we are going in the right direction.

Chairman PICKLE. I am convinced that we are generally going in the right direction, too. I think the committee should give serious consideration to more personnel, if more personnel is needed, a quicker review, or whatever steps are necessary to eliminate the fraudulent claims. If fraudulent claims are knowingly committed, we ought to take positive steps to bring that kind of case to action.

I think your testimony and the testimony of the people here today have been very helpful. I want to thank you for your presence here today. Commissioner Cohen, we are glad to have you with us again. Are there any other questions by members of the committee?

If not, the committee will stand adjourned.

[Whereupon, at 12:40 p.m., the hearing was adjourned.]

APPENDIX

FOR IMMEDIATE RELEASE
FRIDAY, MAY 23, 1986

PRESS RELEASE #21
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1105 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D. C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN,
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES,
ANNOUNCES A HEARING
TO REVIEW THE INTERNAL REVENUE SERVICE'S ART ADVISORY PANEL

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will hold a hearing to review the Internal Revenue Service's Art Advisory Panel and related issues involving charitable contribution deductions of over-valuated artwork. The hearing has been scheduled for Tuesday, June 3, 1986, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 9:30 a.m.

The Subcommittee will consider the IRS's ability to administer the federal tax rules governing the valuation of artwork, the role of the Art Advisory Panel in this process, the extent to which overvaluation of donated artwork continues to be a compliance problem, the involvement of such charitable deductions in tax shelter schemes, the problem of undervaluation of artwork in estate and gift tax cases, and the impact of current law penalty provisions. Witnesses invited to appear at the hearing will be representatives from the Internal Revenue Service, members of the Commissioner's Art Advisory Panel and other interested persons.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Persons submitting written comments for the printed record of the hearing should submit six (6) copies by the close of business, Monday, June 30, 1986, to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515.

SEE ENCLOSED FORMATTING REQUIREMENTS.

COMMITTEE ON WAYS AND MEANS FORMATTING REQUIREMENTS FOR PRINTING OF HEARING STATEMENTS, WRITTEN COMMENTS AND EXHIBITS

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will **not** be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and public during the course of a public hearing, may be submitted in other forms.

BACKGROUND INFORMATION ON ART ADVISORY PANEL

ANNUAL SUMMARY REPORT FOR 1985
OF CLOSED MEETING ACTIVITY OF
THE ART ADVISORY PANEL OF THE
COMMISSIONER OF INTERNAL REVENUE

Six closed meetings of the Commissioner's Art Advisory Panel were held in 1985: Painting and Sculpture on April 10 and October 24; Far Eastern and Asian on April 19 and November 20; Primitive on June 3 and November 5. All meetings were closed to the public by determination of the Commissioner that the substantive discussions and records of the Panel dealt with the value of works of art involved in a federal tax return and are thus concerned with matters listed in sections 552b(c)(3), (4), (6), and (7) of Title 5 of the United States Code. Consequently, the meetings at which such matters are discussed and the records of such meetings should not be open to the public. This is necessary to protect the confidentiality of tax returns under section 6103 of Title 26 of the United States Code.

Art valuation questions arising from audits of income, gift or estate tax returns in the District Offices may be referred to the National Office for review. Appraisals involving art works valued at $20,000 or more must be so referred.

The purpose of the Panel meetings is to discuss and make recommendations regarding the acceptability of taxpayers' appraisals of works of art. If the Panel recommends rejection of a taxpayer's appraisal, it may also recommend a different valuation, or the securing of additional information, or consultation with some specialist.

Prior to the meetings, National Office art appraisers send photographs and written materials to the Panelists concerning the works of art they will be evaluating. The written materials incorporate information from the taxpayer's appraisal reports as well as the results of the staff's own authentication and market research. On a number of items, one or more of the Panelists or staff will have seen the property itself and may comment on the adequacy of the taxpayer's photograph and description. The Panelists are sent all available probative information on each work, such as: size, medium and support, physical condition, history of ownership, public exhibitions, and citations in literature. In addition, Panelists are provided information on public and private sales of apparently similar works by the same artist. They are also informed as to the valuation date and the value actually claimed on the taxpayer's tax return.

Other information, however, is not sent to the Panelists but may be orally introduced if and when necessary.

For example, if a work's physical condition or aesthetic quality is uncertain, its location may be disclosed to facilitate planning an inspection of the work by either one or more current Panelists. Such location information would be introduced even though it would tend to reveal whether the work was involved in a contribution or estate tax situation.

The effect and amount of the tax consequence of raising or lowering a valuation typically is not disclosed to the Panelists. However, since charitable contribution items are virtually never valued conservatively, it is often obvious to the Panelists as to whether the appraisal is for a contribution deduction or for estate tax purposes. Items in contributions tend to be overvalued, while items in estates tend to be undervalued.

The identity of the taxpayer's appraisers is revealed to the Panelists only after they have reached their consensus, unless prior to that time, the Panel recommends Internal Revenue Service consultation with an outside specialist whom the taxpayer has already utilized.

Although taxpayers' names are not sent out to the Panelists, the prominence in the art world of many of the works being valued, or discussed as comparable sales, often results in the identities of taxpayers, and even other art buyers, being recognized by the Panelists. This is the primary reason why Panel meetings are closed to the public. To minimize recognition of taxpayers' identities, the appraisal review discussion is held in alphabetical order by the artists' last names. Appraisals of any one taxpayer's collection are thereby interspersed with the appraisals of other taxpayers. Such commingling of the collections minimizes the likelihood of recognition of a taxpayer's entire collection as such.

After a Panel meeting, the National Office art appraisers prepare a valuation report on each rejected appraisal. The reports are sent to the District Office which initially referred the taxpayer's valuation. The reports are then made available to the taxpayers whose appraisals have been rejected. The referring districts are notified by memorandum on those cases having acceptable appraisals.

In some cases, a taxpayer may then secure additional information to better support the valuation. Such information, if deemed substantive by the staff, is submitted to the Panel for reconsideration at a subsequent meeting.

Incorporated below for the purposes of this annual report, is the summary meeting report prepared by the designated committee manager. This report identifies the times and places of the meetings, the names of attending Panelists and Internal Revenue Service officials, and summarizes the statistics on appraisal reviews of charitable contribution deductions and appraisal reviews of estate and gift returns.

Commissioner

SUMMARY OF
1985
REGULAR MEETINGS OF THE ART
ADVISORY PANEL OF THE
COMMISSIONER OF THE INTERNAL REVENUE SERVICE

Six closed meetings of the Commissioner's Art Advisory Panel were held in 1985: Painting and Sculpture on April 10 and October 24; Far Eastern and Asian on April 19 and November 20; Primitive on June 3 and November 5. The meetings were chaired by Ms. Karen Carolan, Chief of the Art Valuation Section, IRS National Office. The meetings were held in the IRS National Office, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

A list of Panel members and others who attended is attached.

The Panelists reviewed 1538 items with an aggregate taxpayer valuation of $67,885,000 on the 226 taxpayer cases under consideration. The claimed value of the average charitable contribution item was $44,000 and the average estate and gift item was $66,000. The Panelists recommended total adjustments of $23,961,000 claimed on the reviews now concluded for these meetings. On the adjusted items, the Panel recommended adjustments amounting to a 53 percent reduction on the overvalued items in charitable contribution claims and a 66 percent increase on the undervalued items in estate and gift appraisals.

The Panel recommended acceptance of 26 percent of the appraisals reviewed. Adjustments were recommended on 68 percent of the reviewed appraisals. Six percent of the appraisals reviewed by the Panel were indicated as requiring additional staff development before a value decision could be made.

The Panel also reconsidered 21 charitable contribution items valued at $11,227,000 by the taxpayer and $8,545,000 by the Panel. After reviewing the additional information subsequently submitted by the taxpayer, the Panel recommended $8,593,000 as the fair market value on these reconsidered items.

Karen E. Carolan

Karen E. Carolan
CHAIRWOMAN, COMMISSIONER'S ART
ADVISORY PANEL

STATISTICAL SUMMARY

C.

CHARITABLE CONTRIBUTION

Cases Considered by the
Commissioner's Art Advisory Panel during
1985 Calendar Year
IRS National Office, Washington, D. C.

Total taxpayer appraisal items reviewed by the Art Panel

Number of cases	173		
Number of Panel reviewed items	1,266	Total taxpayer claimed value	$50,007,401
Average value of items reviewed	$3,955		
Number requiring further development by the staff (6%)	73	Claimed value on Development Items	$ 2,348,160
		Total taxpayer claimed value on Panel reviews concluded	$47,659,241
Number of appraisal reviews concluded (94%)	1,193	Total Panel recommended valuation on reviews concluded	$30,082,142

			Taxpayer Claim	Panel Value	Adjustment	
Number accepted	261	(20%)	$10,970,792	10,970,792		
Number adjusted	932	(74%)	36,688,449	19,111,350	$17,577,099	
Adjusted +	33	(3%)	+ $ 2,320,966	3,116,000	+ 795,034	
Adjusted -	899	(71%)	- 34,367,483	15,995,350	-18,372,133	(-53%)

Total Panel recommended adjustments on taxpayer valuations	$19,167,167
Net Panel adjustment	$17,577,099

STATISTICAL SUMMARY
OF
CHARITABLE CONTRIBUTION

PAINTING & SCULPTURE

Cases Considered by the
Commissioner's Art Advisory Panel during
1985 Calendar Year
IRS National Office, Washington, D. C.

Total taxpayer appraisal items reviewed by the Art Panel

Number of cases	91		
Number of Panel reviewed items	332	Total taxpayer claimed value	$40,646,829
Average value of items reviewed $122,430			
Number requiring further development by the staff (4%)	12	Claimed value on Development Items	$ 1,751,660
Number of appraisal reviews concluded (96%)	320	Total taxpayer claimed value on Panel reviews concluded	$38,895,169
		Total Panel recommended valuation on reviews concluded	$25,797,882

			Taxpayer Claim	Panel Value	Adjustment	
Number accepted	87	(26%)	$ 8,847,882	8,847,882		
Number adjusted	233	(70%)	$30,047,287	16,950,000	$13,097,287	
Adjusted +	13	(4%)	+ $ 2,250,066	3,007,500	+ 757,434	
Adjusted -	220	(66%)	- $27,797,221	13,942,500	-13,854,721	(-50%)

Total Panel recommended adjustments on taxpayer valuations	$14,612,155
Net Panel Adjustment	$13,097,287

STATISTICAL SUMMARY

CHARITABLE CONTRIBUTION

FAR EASTERN & ASIAN

Cases Considered by the
Commissioner's Art Advisory Panel during
1985 Calendar Year
IRS National Office, Washington, D. C.

Total taxpayer appraisal items reviewed by the Art Panel

Number of cases	44		
Number of Panel reviewed items	339	Total taxpayer claimed value	$4,247,937
Average value of items reviewed	$12,530		
Number requiring further development by the staff (4%)	12	Claimed value on Development Items	$ 294,000
		Total taxpayer claimed value on Panel reviews concluded	$6,624,800
Number of appraisal reviews concluded (96%)	327	Total Panel recommended valuation on reviews concluded	$1,500,175

			Taxpayer Claim	Panel Value	Adjustment	
Number accepted	40	(11%)	$ 529,000	$ 529,000		
Number adjusted	287	(85%)	3,424,937	971,175	$ 2,453,762	
Adjusted +	5	(1%)	+ 21,200	35,800	+ 14,600	
Adjusted -	282	(84%)	- 3,403,737	935,375	- 2,468,362	(-73%)

Total Panel recommended adjustments on taxpayer valuations	$2,482,962
Net Panel Adjustment	$2,453,762

STATISTICAL SUMMARY
OF
CHARITABLE CONTRIBUTION

Cases Considered by the
Commissioner's Art Advisory Panel during
1985 Calendar Year
IRS National Office, Washington, D. C.

PRIMITIVE

Total taxpayer appraisal items reviewed by the Art Panel

Number of cases 38

Number of Panel reviewed items 595

Total taxpayer claimed value $5,112,635

Average value of items reviewed
$8,593

Number requiring further development by the staff (8%) 49

Claimed value on Development Items $ 302,500

Total taxpayer claimed value on Panel reviews concluded $4,810,135

Number of appraisal reviews concluded (92%) 546

Total Panel recommended valuation on reviews concluded $2,784,085

			Taxpayer Claim	Panel Value	Adjustment	
Number accepted	134	(23%)	$ 1,593,910	$1,593,910		
Number adjusted	412	(69%)	3,216,225	1,190,175	$ 2,026,050	
Adjusted +	15	(2%)	+ $ 49,700	72,700	+ 23,000	
Adjusted -	397	(67%)	- 3,166,525	1,117,475	- 2,049,050	(-65%)

Total Panel recommended adjustments on taxpayer valuations $2,072,050

Net Panel adjustment $2,026,050

STATISTICAL SUMMARY
OF
ESTATE AND GIFT

Cases Considered by the
Commissioner's Art Advisory Panel during
1985 Calendar Year
IRS National Office, Washington, D. C.

Total taxpayer appraisal items reviewed by the Art Panel

Number of cases 53

Number of Panel reviewed items 272

Average value of items reviewed $65,731

Number requiring further development by the staff (7%) 18

Number of appraisal reviews concluded (93%) 254

Total taxpayer claimed value $17,878,916

Claimed value on Development Items $ 830,000

Total taxpayer claimed value on Panel reviews concluded $17,048,916

Total Panel recommended valuation on reviews concluded $19,383,316

			Taxpayer Claim	Panel Value	Adjustment	
Number accepted	136	(50%)	$ 7,707,516	7,707,516		
Number adjusted	118	(43%)	9,341,400	11,675,800	$2,334,400	
Adjusted +	83	(31%)	+ $ 5,417,600	8,982,000	+3,564,400	(+66%)
Adjusted -	35	(13%)	- 3,923,800	2,693,800	-1,230,000	

Total Panel recommended adjustments on taxpayer valuations $ 4,794,400

Net Panel adjustment $ 2,334,400

STATISTICAL SUMMARY

ESTATE AND GIFT

PAINTING & SCULPTURE

Cases Considered by the
Commissioner's Art Advisory Panel during
1985 Calendar Year
IRS National Office, Washington, D. C.

Total taxpayer appraisal items reviewed by the Art Panel

Number of cases 51

Number of Panel reviewed items 268

Total taxpayer claimed value $17,774,166

Average value of items reviewed $66,321

Number requiring further development by the staff (6%) 16

Claimed value on Development Items $ 730,000

Total taxpayer claimed value on Panel reviews concluded $17,044,166

Number of appraisal reviews concluded (94%) 252

Total Panel recommended valuations on reviews concluded $19,377,816

			Taxpayer Claim	Panel Value	Adjustment	
Number accepted	135	(50%)	$7,703,516	7,703,516		
Number adjusted	117	(44%)	9,340,650	11,674,300	$2,333,650	
Adjusted +	82	(31%)	+ $5,416,850	8,980,500	3,563,650	(+66%)
Adjusted -	35	(13%)	- 3,923,800	2,693,800	1,230,000	

Total Panel recommended adjustments on taxpayer valuations $ 4,793,650

Net Panel adjustment $ 2,333,650

STATISTIC SUMMARY
Of
ESTATE AND GIFT

FAR EASTERN & ASIAN

Cases Considered by the
Commissioner's Art Advisory Panel during
1985 Calendar Year
IRS National Office, Washington, D. C.

Total taxpayer appraisal items reviewed by the Art Panel

Number of cases	2		
Number of Panel reviewed items	4	Total taxpayer claimed value	$104,750
Average value of items reviewed	$26,187		
Number requiring further development by the staff (50%)	2	Claimed value on Development Items	$100,000
Number of appraisal reviews concluded (50%)	2	Total Panel recommended valuation on reviews concluded	$ 4,750
		Total taxpayer claimed value on Panel reviews concluded	$ 750

			Taxpayer Claim	Panel Value	Adjustment
Number accepted	1	(25%)	$ $4,000	4,000	
Number adjusted	1	(25%)	$ 750	1,500	750
Adjusted +	1	(25%)	+ $ 750	1,500	+750
Adjusted -	0	(-%)	-		

Total Panel recommended adjustments on taxpayer valuations	$ 750
Net Panel Adjustment	$ 750

Department of the Treasury

Internal Revenue Service
Washington, D.C. 20224

CHARTER

THE ART ADVISORY PANEL

OF THE

COMMISSIONER OF INTERNAL REVENUE

This Charter is prepared and filed in accordance with the provisions of the Federal Advisory Committee Act, 5 U.S.C. app. (1976).

A. Official Title. The Committee's official designation is: The Art Advisory Panel of the Commissioner of Internal Revenue.

B. Objectives and Scope. The Committee's objectives and scope of its activity are: to assist the Internal Revenue Service by reviewing and evaluating the acceptability of property appraisals submitted by taxpayers in support of the fair market value claimed on works of art involved in Federal Income, Estate, or Gift taxes in accordance with sections 170, 2031, and 2512 of the Internal Revenue Code of 1954 (hereinafter cited as Code). This activity is based on the authority to administer the Internal Revenue law conferred upon the Secretary of the Treasury by section 7801 of the Code and delegated to the Commissioner of Internal Revenue.

C. Time Period. The period of time necessary for the Committee to carry out its purpose is indeterminate in that the need for the Committee recurs regularly during the audit of Federal Income, Estate and Gift tax returns. One or two-day Panel meetings have been held two or three times a year since 1968.

D. Reporting. The official to whom the Committee reports is the Commissioner of Internal Revenue.

E. Support Service. The agency responsible for providing the necessary support for the Committee is the Internal Revenue Service.

F. Duties. A description of the duties, all of which are solely advisory, for which the Committee is responsible are as follows:

1. Prior to a meeting of the Panel, each panelist independently examines photographic copies of the works of art and reviews the text of appraisal reports secured and submitted by the taxpayer in support of the claimed valuation. The panelists are not told the identity of the taxpayer, or of the taxpayer's appraiser, or the tax consequences of adjusting the valuation up or down.

2. At the Panel meeting members are invited to express their opinions as to the acceptability of the claimed valuation. Those panelists who disagree with a taxpayer's valuation may state their own estimate of value and the reasons therefor.

In formulating their independent valuations, panelists consider such matters as the authenticity of the claimed artistic attribution, the selling prices of comparable works of art, and other expert opinions. Panelists may also consider the condition, historic importance or aesthetic qualities of the subject art work. In some instances, the panelists provide the names of other appropriately qualified experts who are needed to do further study, or to testify as government witnesses in the event of litigation. Occasionally, a panelist might serve as such a witness. Discussion on each appraised item continues until a consensus of value is reached. The consensus of value is announced as the official advisory conclusion by the chairperson of the Panel who moderates the discussions. This full time IRS employee, who specializes in the appraisal of personal property, then so informs the IRS director of the district from which the case was referred.

G. Annual Operating Costs. The estimated annual operating cost in dollars and staff-years is as follows: Panelists are not paid for their time or services; consequently the major operating costs consist of reimbursing the panelists for their travel and lodging expenses for six meetings in Washington, D.C. each year. This amounts to approximately $15,000. One staff-year of a regular employee is required to administer the Panel and to handle the preparation and follow through on the approximately 1,000 art appraisals reviewed annually by the Panel.

M. Number and Frequency of Meetings. The estimated number and frequency of committee meetings are: six one-day meetings each year.

I. Termination Date. The services of the Committee are expected to be needed for two years. Unless formally continued, the termination date will be two years from the filing date.

J. Filing Date. The date of filing of this Charter is

Acting Commissioner of Internal Revenue — Date: 12-31-81

Approved: Date 12.6, 1982

D. Edward Wilson Jr. (Actg)
Assistant Secretary (Management)

Art Advisory Panel of the Commissioner of Internal Revenue

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of determination of necessity for reestablishment of the Art Advisory panel.

SUMMARY: It is in the public interest to continue the existence of the Art Advisory panel.

FOR FURTHER INFORMATION CONTACT: Karen Carolan, CC:AP:V:4, 1111 Constitution Avenue, NW., Room 2878, Washington, DC 20224, Telephone No. (202) 566-6288 (not a toll free number).

Pursuant to the Federal Advisory Committee Act, 5 U.S.C. App. (1982), the Commissioner of Internal Revenue announces the reestablishment of the following advisory committee:

Title. The Art Advisory Panel of the Commissioner of Internal Revenue.

Purpose. The Panel assists the Internal Revenue Service by reviewing and evaluating the acceptability of property appraisals submitted by taxpayers in support of the fair market value claimed on works of art involved in Federal income, Estate or Gift taxes in accordance with sections 170, 2031, and 2512 of the Internal Revenue Code of 1954.

Providing this assistance requires Panel records and discussions to include tax return information. Therefore, the Panel meetings will be closed to the public since all portions of the meetings will concern matters that are exempted from disclosure under the provisions of section 552b(c) (3), (4), (6) and (7) of Title 5 of the U.S. Code. This determination, which is in accordance with section 10(d) of the Federal Advisory Committee Act, is necessary to protect the confidentiality of tax returns and return information as required by section 6103 of Title 26 of the U.S. Code.

Statement of Public Interest. It is in the public interest to continue the existence of the Art Advisory Panel. The Secretary of Treasury, with the concurrence of the Office of Management and Budget, and the General Services Administration, has also approved continuation of the Panel. The membership of the Panel is balanced between museum directors and art dealers to afford differing points of view in determining fair market value.

Authority. The authority for this Panel will expire two years from the date the charter is approved by the Assistant Secretary of the Treasury for Administration and filed with the appropriate congressional committees unless, prior to the expiration of its charter, the Panel is renewed.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the Federal Register for Wednesday, November 8, 1978. (43 FR 52122).

Roscoe L. Egger, Jr.,

Commissioner.

[FR Doc. 86-5427 Filed 3-11-86; 8:45 am]

BILLING CODE 4830-01-M

INFORMATION ON
THE ART ADVISORY PANEL
OF THE
COMMISSIONER OF INTERNAL REVENUE
IN ACCORDANCE WITH SECTION 8.a OF
TD 10-06.E

(1) PURPOSE

The Panel assists the Internal Revenue Service by reviewing and evaluating the acceptability of property appraisals submitted by taxpayers in support of the fair market value claimed on works of art involved in Federal Income, Estate and Gift taxes in accordance with the Internal Revenue Code.

The Art Panel was created in 1968 to foster voluntary compliance with Federal tax laws. Since the art valuation area remains an area particularly susceptible to abuse, the service of the Panel is critical for effective administration of Federal tax laws.

(2) INADEQUACY OF ALTERNATIVES TO THE PANEL

The Panel's information and recommendations play an important part in the efforts of the Internal Revenue Service to administer the high abuse area of art valuation. The information and advice the Panelists provide cannot be obtained effectively from within IRS and does not duplicate the work performed in IRS or elsewhere.

While the National Office art appraisal staff produces appraisals utilizing public information, the Panel provides information on private treaty sales based on their own experience as dealers and from inside information obtained from other members of their relatively small industry. Such information is not widely known, nor generally shared with outsiders. As dealers, scholars, and authors, the Panelists' knowledge is particularly beneficial in the authentication of works of art.

The alternative of utilizing independent contract art appraisers has been found to be unsatisfactory. The IRS has found that such persons are difficult to identify, very costly, and are often reluctant to provide a service to IRS that may result in controversy with colleagues, as well as with prospective clients.

(3) EXPECTED DURATION

The Panel has been chartered and regularly renewed by the Secretary since the passage of the Federal Advisory Committee Act in 1972. The current charter expires in March 1986.

In view of past experience, the duration of the Panel is indeterminate since the need for the Panel recurs regularly during the audit of Federal Income, Estate and Gift tax returns.

(4) BALANCE OF VIEW POINTS

The Panel is balanced to provide varied points of view. To ensure optimum representation of divergent seller and buyer perspectives regarding art market trends and values, the Panel composition is balanced with eight to ten art dealers and fifteen to seventeen museum directors, curators and scholars. The Panelists serve two year terms. Specialists in each of the major schools and periods of art are selected. All Panelists are subject to review and reappointment annually.

Continuing care is given to insure that the Panel's advice and recommendations are not influenced by special interests. All Panelists are processed as Special Government employees with the required financial disclosure and review and approval by the Ethics Committee of the Department. Included is a thorough review of employment interests, including their business and professional affiliations.

(6) ESTIMATED COSTS

The Panelists are not paid for their services. The only direct expense is approximately $12,000 for their travel and lodging. One staff year of a regular employee is required to administer the Panel.

(7) EFFECTIVE USE OF PANEL ADVICE

Since renewal of the charter in March 1984, the Art Advisory Panel has held nine closed meetings. The Panelists reviewed approximately 2140 items with an aggregate taxpayer valuation of about $130,000,000. The Panelists recommended total adjustments of approximately $20,000,000 on the reviews concluded.

The Panel provides an essential service and is an extremely cost-effective method in IRS's efforts to deal with an area highly susceptible to abuse. The recommendations made by the Panel are used by the District Directors of Internal Revenue in the tax adjustment and audit programs, and by other IRS staff in appellate and litigation activities.

(6) If the engineer's recommendations are changed before the taxpayer is furnished Part II of the complete Engineering and Valuation Report a revised complete Engineering and Valuation Report will be prepared and submitted according to (1) through (5) above.

42(16)2.6 *(1-25-83)*
Regional Office Responsibility

The regional offices will furnish courtesy copies of their established criteria and guideline procedures for the engineering referral and classification activities to the National Office for informational purposes. This information should be addressed to the Assistant Commissioner (Examination), Attention: OP:EX:S:C and be received in the National Office at the same time the criteria and procedures are issued to the districts.

42(16)3 *(10-23-80)*
Effect of Engineer's Recommendations

(1) The recommendations of the engineer will be adopted as the position of the Service unless there are clear and compelling reasons for not doing so. Because case managers in Coordinated Examination Program audits or internal revenue agents in non-coordinated examination audits have the overall responsibility for the return being examined, including the engineering issues, it is incumbent on them to be involved in and conversant with such issues. Complete accord should be reached with regard to examination procedures and techniques to be employed by the engineer revenue agent (i.e., scope and depth) in the identification and development of those issues. This joint effort should ensure that the position taken pertaining to the engineering issues at the examination level reflect the views of both individuals and meet their respective responsibilities to the case.

(2) If differences of opinion should occur between the engineer and the case manager or revenue agent, they will be resolved as follows.

(a) In other than Coordinated Examination Program audits (as defined in IRM 42(11)3:(1)) differences will be resolved jointly by the managers of the engineer and the revenue agent.

(b) If agreement cannot be reached at this level, the decision should be made at the next level of supervision having jurisdiction over the two managers.

(c) If the managers are located in different districts, the next level of supervision in the district having jurisdiction over the case should resolve the differences.

(d) In Coordinated Examination Program audits, see IRM 42(11)7.7:(3) and (5).

42(16)4 *(10-23-80)*
Valuation Assistance for Cases Involving Works of Art

42(16)4.1 *(11-6-84)*
Art Advisory Panel

(1) The Commissioner maintains an Art Advisory Panel of nationally prominent art museum directors, curators and art dealers to systematically aid the Service in the review of Service-selected cases involving taxpayer valuations on major art objects, principally American and European paintings and sculpture. Early in 1984, the membership of the Panel was increased from 12 to 25 members to provide expertise in Pre-Columbian, Primitive, Far Eastern and Asian Art. These ten new members include art dealers, art history scholars, and museum directors and curators who are expert in these areas. This expansion in the size of the Panel was made to accommodate Oriental and Primitive art forms because they have emerged as major areas of charitable contributions and have been identified as potential areas of tax abuse.

(2) The Art Valuation Group (CC:EE:V:4) in the Engineering and Valuation Branch provides the staff support and coordination of the Panel's functions.

(3) If the panel members, after individual study of the taxpayer's photography and other documentation, and after panel discussion, question the taxpayer's value, they will so indicate and typically recommend a specific valuation. Such recommendations are advisory only; however, after review by the National Office Art Valuation Group staff, such recommendations become the position of the Service.

(4) If agreement cannot be secured with the taxpayer at the adjusted amount, further assistance may be requested of the Panel and the National Office Art Valuation Group. When appropriate, the Office of Associate Chief Counsel (Technical) will arrange with prominent art authorities to make detailed appraisals for cases which involve significant indications of tax abuse or where a wide divergence of Fair Market Value (FMV) opinion exists. This appraisal program supplements the Art Advisory Panel review when case facts warrant this action.

42(16)4.2 (11–10–82)
Criteria for Requesting Art Valuation Assistance

(1) Definition of a work of art: a painting, drawing, print, sculpture or antique furnishing, but not literary, dramatic, musical or historical memorabilia.

(2) Any taxpayer's appraisal of a single work of art with a claimed value of $20,000 or more must be referred to the National Office for review by the Commissioner's Art Advisory Panel. However, in cases that involve more than one such item, the requesting district office should refer all such appraisals in excess of $20,000 for sample selection. The National Office Art Valuation Group will select from such referrals representative items for review by the Panel and request photos and other essential information and materials necessary for FMV determination.

(3) Telephone discussions with the National Office Art Valuation Group are encouraged in order to take advantage of expert advice and to facilitate the handling of all referrals for valuation assistance in these instances.

42(16)4.3 (11–6–84)
Referral Procedures for Requesting National Office Assistance in Art Valuations

(1) Requests to the National Office for assistance in art valuation matters should follow Region/District procedures and be addressed to:

Art Valuation Group CC:E:E:V:4
Attn: Works of Art
Room 2575, National Office
Internal Revenue Service Building
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

(2) Examiners requesting valuation assistance on works of art should include in their referrals to the appraisal specialists the following information and items necessary for determining the FMV of each object.

(a) A completed Form 5202 (Request for Engineering Services).

(b) A professional quality 8 inches by 10 black and white photograph and a 5 inches by 7 color transparency of the object. The donor, donee, appraiser or executor of the estate generally has a photoprint of the item.

(c) A complete description of the item, indicating:

1 size (cite actual dimensions for paintings),

2 title or subject matter,

3 medium, (oil on canvas, w/c on paper, etc.)

4 name of artist, (sculptor, etc.),

5 date created, and

6 any marks, symbols or labels on the back or bottom of the object.

(d) Cost, date and manner of acquisition.

(e) Claimed FMV and a copy of the appraisal materials filed with the return.

(f) The present location of the art object if it becomes necessary to arrange an inspection.

(g) History (provenance) of the item including proof of authenticity if such information is available.

(h) A record of exhibitions at which the work of art was displayed.

(i) Sales prices of other comparable works of art sold by the artist.

(j) Quoted prices in dealers' catalogs of the artist's work.

(3) Any pertinent factors or knowledges gathered as to the accuracy of the claimed FMV should be set out on a separate page in the request.

(4) While the items listed in subparagraph (2) above represent the ideal informational background required for valuation determinations at the National Office level, it is understood that each item of information will not be readily available in every case. However, it is emphasized that the validity of the FMV findings and recommendations by the Art Advisory Panel is greatly enhanced and facilitated by complete and accurate information on each object of art to be reviewed. Scant information hinders or in some cases precludes meaningful consideration. Accordingly, items (a) through (h) in subparagraph (2) above should, when possible, accompany all art valuation requests. The remaining items, while very helpful and desirable, are not as essential.

(5) The National Office Art Valuation Group is also available to provide telephonic assistance to field examiners in determining the FMV of many objects of art that have return values of

less than $20,000. Examiners are encouraged to take advantage of this expert advice for such items as paintings, watercolors, prints, lithographs, etchings, drawings and sculpture. The valuation specialists in the Art Valuation Group may be reached at FTS 566-4138. However, prior to making a telephone call to the National Office to discuss the monetary worth of any item, the examiner should ascertain as many as possible of these essential facts necessary for determining its fair market value.

(a) Name of artist.
(b) Description of item indicating:
1 the medium,
2 title,
3 size,
4 date created, and
5 any distinguishable marks, symbols or labels.
(c) Date acquired by taxpayer.
(d) Valuation date.
(e) Cost of acquisition.
(f) Claimed FMV.

(6) If a questionable individual item appraisal under $20,000 has substantial significance and the aggregate number of dollars in the case is large, the National Office Art Valuation Group, upon request, will provide, as available, guidance to resources for review assistance short of referral to the Art Advisory Panel. Upon request, similar valuation review assistance will also be provided, as available, for literary, dramatic or musical property or historic memorabilia.

42(16)4.4 *(11-19-82)*
National Office Coordination

(1) The complete referral file (request for valuation assistance with the essential information and material identified in IRM 42(16)4.3:(2) above) received from the examiner will be reviewed and perfected by the Art Valuation Group prior to referral to the Art Advisory Panel or an outside appraiser.

(2) A fixed schedule of meeting dates for the Art Advisory Panel has not been established. However, in recent years it has become the practice of the Panel to meet in the National Office not less than twice in any calendar year. Notice of these closed meetings are published in the Federal Register usually 6 weeks prior to each meeting date. Accordingly, requests for valuation assistance should be initiated as early as possible in the examination of returns involving works of arts in order to allow sufficient time for the National Office review procedures.

(3) To assist in case planning and control, the Art Valuation Group will advise district offices of estimated completion dates especially when facts and circumstances in specific cases indicate any abnormal delay in the completion date.

(4) In the final disposition of a case by the National Office Art Valuation Group, recommendations for acceptance or rejection of claimed values will be made to the district offices based primarily on the Panel's conclusions.

(5) Requests for information regarding the status of specific cases referred for art valuation assistance under IRM 42(16)4 should be directed to National Office, Corporation Tax Division, Attention: Engineering and Valuation Branch CC:C:E.

42(16)4.5 *(11-6-84)*
Follow-up Procedures

(1) A closing memorandum report of findings and recommendations is prepared on each case referred to the National Office for valuation assistance by the Art Valuation Group and the Commissioner's Art Advisory Panel. The appraisal specialists in the Art Valuation Group will fill in Part I of Form 8256, Art Valuations, National Office Art Valuation Group—Field Response, and attach it to the National Office closing memorandum report. The Group Manager of any examiner who has received assistance from the National Office will ensure that the information found in Part I of Form 8256 is updated by completing the Examination portion of Part II immediately upon closing the case. The updated original Form 8256 with the National Office closing memorandum report will remain in the case workpaper file after being indexed on Examination Workpapers Form 4318 or on Estate Tax Preplanning and Audit Workpaper Cover Sheet Form 5225 as provided in IRM 4366, Appraisal of Works of Art. A copy of the updated Form 8256 will be forwarded to:

Internal Revenue Service
Associate Chief Counsel (Technical)
1111 Constitution Avenue N.W.
Washington, D.C. 20224
Attn: CC:[illegible]V:4 Room 2575
(Name of National Office Appraiser)

(2) To further enhance the valuation assistance provided by the National Office, field offices are encouraged to include comments and attach any supporting statements that would be beneficial to the viability of this program. See Exhibit 42(16)0-13.

(Next page is 4200-380.1)

Exhibit 42(16)0-13

Art Appraisal Follow-up Reporting Form

Art Valuation

National Office Art Valuation Group – Field Office

Part I

The Art Valuation Group will fill in Part I for each case referred to the National Office for valuation assistance. Form 8256 will be completed in the referring field office as part of the National Office closing memorandum.

Taxpayer	Tax Year(s)	Person to Contact
Publick, John Q.	1982	Art Gruppe
Panel Meeting Date	Control Number	Phone No. (FTS) [X] Yes [ ] No
4/15/84	443222	213-2121

Item(s) one painting by Jack Painter, Landscape with sunset

Fair Market Value:

Claimed per return $ 50,000

Recommended by National Office Art Valuation Group $ 1,000

Part II

Each office that completes the valuation issue in a case that has received assistance from the National Office Art Valuation Group must update the summary information found above in Part I by completing the applicable portion of Part II immediately upon closing the case. The retained original Form 8256 will remain in the case file and a copy of such update will be forwarded as follows:

Examination / District Counsel
(email address to)

Internal Revenue Service
Associate Chief Counsel (Technical)
1111 Constitution Avenue, N.W.
Washington, D.C. 20224
Attn: CC:C:E:V:4 Room 3516 A. Gruppe

Appeals (email address to)

Internal Revenue Service
Director, Appeals Division
1111 Constitution Avenue, N.W.
Washington, D.C. 20224
Attn: CC:AP:PT Room 2513

Field Office	Examination	Appeals		Counsel
		Nondocketed	Docketed	
Closing Value	$ 1,000	$	$	$
Agreed	[X]	[ ]	[ ]	[ ]
Unagreed	[ ]	[ ]	[ ]	[ ]
Date Closed	7-24-84			
Office Location	Boston			
Name	E.K. Aminer			
Phone	123-4567			

Comments and supporting statements (attached)

Form 8256 (7-84) Department of the Treasury – Internal Revenue Service

Procedures and Services

of the National Office Art Valuation Section

APPRAISER:_____ PHONE:_____

The appraiser listed above was assigned to this case and may be contacted for further information and assistance.

ART ADVISORY PANEL

The Panel, first authorized by the Secretary of the Treasury in 1968,. is composed of prominent art specialists and authorities who assist the Service in determining the authenticity and the fair market value of works of art in estates and gift or income tax returns. In 1984, the membership of the Panel was increased from twelve to twenty-five members to provide expertise in Pre-Columbian, Primitive, Far Eastern and Asian art. The Art Advisory Panel consists of distinguished museum directors and curators, art historians and scholars, and prominent dealer experts.

The Panel members are appointed by the Commissioner as "special government employees" of the Internal Revenue Service and generally meet three times a year in Washington, D.C. They are subject to IRS employee clearance procedures and are bound by the laws prohibiting disclosure of information from tax returns. All meetings of the Panel are planned and conducted by members of the Art Valuation Section of the Valuation Branch, Appeals Division, Office of Chief Counsel in the National Office.

The Panel meetings, which are closed to the public to prevent disclosure of tax return information, the taxpayer's appraisal and any other supporting evidence submitted is reviewed together with additional research developed by the IRS National Office Art appraisers. The Panelists have the opportunity to present their own independent research and findings regarding the value of each art item under consideration. The Panel's conclusions are reviewed reviewed by the Valuation Section of the National Office and recommendations of fair market value are sent to the requesting office in accordance with IRM 4216.3.

To assist taxpayers' understanding of the Art Advisory Panel's conclusions, a report detailing its determination together with a list of its members is attached. Both are to be given to the taxpayer.

NATIONAL OFFICE APPRAISERS

The National Office Art appraisers provide art valuation assistance on works of art not reviewed by the Panel, such as furniture, decorative arts, carpets, historical artifacts, ancient art, archival materials and other personal property.

RECONSIDERATION OF VALUE DETERMINATIONS

The taxpayer may request reconsideration by the National Office of an adjusted claimed value only if he provides additional, evidence such as comparable sales data or other relevant facts to support his fair market value opinion. The taxpayer's request must respond specifically to the report provided by this office. If the claimed attribution was rejected, the taxpayer must provide a provenance or a complete chain of ownership of the work of art to support the attribution. A comprehensive report from a recognized authority on the artist or school to which the work is ascribed should also be attached. Technical test reports, citations in scholarly publications, and accession or exhibition records should also be submitted.

Photographic documentation of the subject property must be of professional quality, preferably a 4 X 5 inch color transparency and an 8 X 10 inch black and white photograph. Comparable sales should also be illustrated with high quality photographs.

APPEALS ASSISTANCE

The National Office Art appraisers will provide assistance to Appeals Officers in those cases involving art valuation previously reviewed either by the Art Advisory Panel or by a National Office appraiser. Upon request the designated appraiser will participate in taxpayer conferences, will prepare a detailed report for use in trials, and will testify as an expert witness in support of the report, or will assist to provide out-Service expert testimony.

ART VALUATION SECTION
1985 CASE RESPONSE STATISTICS

Attached are statistics compiled from Form 8286 received in 1985. The results have been separated by Examination and Appeals levels as well as by art area. In addition, information was also compiled on results of docketed cases.

The Art Section will keep an on-going and up-to-date list of the case responses and will computerize this data for management purposes.

1985 Form 8283
Case Response Results

I. Examination level:

A. Art Advisory Panel:

1. Painting & Sculpture

Charitable Contributions:

T/P's	Items	T/P Value	IRS Value	Agreed	Unagreed
19	41	$2,172,916	$1,199,000 (-45%)	5*	12
		* 626,500	430,600 (-32%)	(29%)	
Estates:					
12	53	$4,437,100	$5,738,000 (+29%)	10*	2
		*2,526,250	3,115,000 (+23%)	(83%)	
		Total Painting Panel		(52%)	

2. Primitive

8	79	680,342	427,270 (-37%)	4*	4
		* 438,676	288,870 (-34%)	(50%)	

3. Oriental

2	7	221,000	36,550 (-83%)	2 (100%)	

Total:	41	180	CC: $3,074,258	662,820 (-78%)	11	16
			*1,286,176	756,020 (-41%)	(41%)	
			ent: 4,437,100	5,738,050 (+28%)		—
			*2,526,250	3,115,600 (+23%)	10 (83%)	2
					21	18

54% agreement on total
Panel responses received

					21	18

B. Staff

1. Tax Shelter

T/Ps	Items	T/P Value	IRS Value	Agreed	Unagreed
6	6	$ 602,100	$ 19,925 (-97%)	1* (17%)	5
		* 79,600	19,925 (-75%)		

2. Other

7	53	505,125	218,892 (-57%)	3*	4
		* 224,625	143,447 (-36%)	(47%)	

Total:	13	59	1,107,225	238,817 (-78%)	4*	9
			* 304,225	163,372 (-46%)	(31%)	

Total Panel and Staff:

54	239		25	27

48% agreement on total responses received

STATEMENT OF EMPLOYMENT AND FINANCIAL INTERESTS

(This information will be treated in confidence)
(For Special Government Employees)

PART I.–TO BE COMPLETED BY AGENCY

1. Name (last, first, initial)	3. Department or agency and major organizational segment
2. Birth date (month, day, year)	4. Period of appointment, this agency – From: To:

5a. Estimated number of days on which services are expected to be performed –

(1) with this agency .....

(2) with other Federal agencies .....

Total number of days (sum of a (1) and (2)) .....

b. Number of days already worked for this and other Federal agencies during applicable 365-day period .....

c. Total number of days (sum of a and b) .....

6. Appointee is designated as a:

☐ Special Government Employee

☐ Regular Government Employee

PRIVACY ACT STATEMENT

GENERAL.–This information is provided pursuant to Public Law 93-579 (Privacy Act of 1974), December 31, 1974, for individuals completing Statements of Employment and Financial Interests.

AUTHORITY.–18 USC 201 et seq. and Section 402 of Executive Order 11222 dated May 8, 1965, and 5 CFR Part 735, and 31 CFR Part 0.735.

PURPOSES AND USES.–This information is used by appropriate reviewing officials to determine whether or not your financial interests, or those of your spouse, minor child, partner, organization in which you are serving as an officer, director, trustee, partner or employee, or any person or organization with whom you are negotiating or have any arrangement concerning prospective employment, may result in a conflict or apparent conflict of interest with your duties and responsibilities as a Federal employee.

EFFECTS OF NONDISCLOSURE.–The filing of complete and accurate statements is mandatory for employees and prospective employees in positions subject to the requirement. The refusal of an employee or prospective employee to submit a statement when required would be a violation of that requirement and would have to be dealt with accordingly, including removal from the position or non-appointment.

PART II.–TO BE COMPLETED BY APPOINTEE

1. Federal Government Employment.–List all other Federal agencies and other organizational segments of this Department or Agency in which you are presently employed. (Use an extra sheet of paper if needed.) If none, write NONE.

DEPARTMENT AND LOCATION	TITLE OR KIND OF POSITION	APPOINTMENT PERIOD From–	APPOINTMENT PERIOD To–	ESTIMATED NO. OF DAYS

(Statement continued on reverse)

Form TD 3084 (1-76)

63-274 O - 87 - 4

TAX INQUIRY AND DISCLOSURE AUTHORIZATION FOR ADVISORY OR VOLUNTEER COMMITTEE MEMBERS

(For use by potential appointees to an advisory or volunteer committee within the Treasury Department.)

I understand that I am being considered for appointment to an advisory or volunteer committee within the Treasury Department. I have been advised that pursuant to Treasury regulations a tax check must be performed before I can be appointed to determine:

1. Whether I have filed Federal income tax returns for the immediately preceding three years. If the tax check request is received by Internal Revenue Service after July 1, then the three years referred to are the year for which a return is required to be filed prior to July 1 (without reference to extensions), and the immediately preceding two tax years. If the tax check request is received by Internal Revenue Service prior to July 1st, then the three years referred to are the most recent three years available in the files of the Internal Revenue Service. Returns delinquently filed subsequent to the date I have affixed to this authorization will be reported as such to the Requester.

2. Whether I have failed to pay any tax within ten days after notice and demand during the same period;

3. Whether during those three years or the current year a penalty has been assessed against me under the Internal Revenue Code for negligence, or whether any such penalty is proposed;

4. Whether I am now or ever have been the subject of an investigation for possible criminal offenses under the internal revenue laws and the results of any such investigation;

5. Whether a civil penalty for fraud has been assessed or is proposed to be assessed against me under the Internal Revenue Code.

6. In the event of a response in the negative to subparagraph 1 or a response in the affirmative to subparagraph(s) 2, 3, 4, or 5 (herein referred to as an "adverse response"), I hereby authorize the Internal Revenue Service to provide to the Assistant Secretary (Administration), or his/her designee, upon written request from the Assistant Secretary (Administration), any additional tax information pertaining to such adverse response.

I have also been advised that if I am appointed, an income tax filing record check will be performed annually during my tenure in the position to verify that a tax return has been filed by me for the then immediately preceding tax year.

WAIVER OF CLAIMS

If requested, I will accept employment as an expert of the Commissioner's Art Advisory Panel and expect to serve without compensation. I agree in advance to waive any and all claims against the Government on account of such services.

Signed _____

Date _____

Form **8282**
(February 1985)
Department of the Treasury
Internal Revenue Service

Donee Information Return

(Sale, Exchange, or Trade of Donated Property)

OMB No. 1545-0908
Expires 12-31-87

Give Copy to Donor

Charitable organization (donee) name | Employer identification number

Please print or type

Number and street

City or town, state, and ZIP code

Name of donor(s) who contributed the gift | Donor identification number

Donor address (Number and street)

City, town or post office, state and ZIP code

(a) Description of donated property sold, exchanged, or traded (Attach a separate sheet if more space is needed)	(b) Date donor(s) contributed	(c) Date donor(s) sold, exchanged, or traded	(d) Amount received

Instructions

Paperwork Reduction Act Notice.—We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

New Law.—The Tax Reform Act of 1984 (P.L. 98-369) requires the donee of any charitable deduction property who sells, exchanges, or otherwise disposes of the property within two years after the date of receipt of the property to file information shown on this return with the Internal Revenue Service.

Charitable Deduction Property.—The term "charitable deduction property" means any property (other than money or publicly traded securities) contributed after December 31, 1984, with respect to which the donee signed Form 8283, Noncash Charitable Contributions Appraisal Summary.

When to File.—Form 8282 must be filed with the IRS within 90 days after the donee disposes of the property. Also, the donee must send a copy of this form to the donor.

Where to File.—File this form with the Internal Revenue Service Center in Cincinnati, OH 45944.

Penalties.—Failure to file this information return and failure to furnish a copy of this return to the donor will make the charitable organization liable for a $50 penalty for each failure. See sections 6652, 6676, and 6678 of the Internal Revenue Code.

Department of the Treasury
Internal Revenue Service

Publication 561
(Rev. Nov. 85)

Determining the Value of Donated Property

Introduction

You may take a charitable contribution deduction, under certain conditions, on your federal income tax return for a contribution or gift to, or for the use of, a qualified organization. To figure how much you may deduct for property that you contribute, you must first determine its *fair market value*.

This publication is designed to help donors and appraisers determine the value of property (other than cash) that is given to qualified organizations. It includes the kind of information you must have to support the charitable contribution deduction you claim on your return.

For more information on charitable contributions, see Publication 526, *Charitable Contributions*.

Penalty. You may be liable for a penalty if you overstate the value (or adjusted basis) of donated property. The penalty is 30% of the underpayment of tax related to the overstatement. In general, you are liable for the penalty if:

1) The value, or adjusted basis, claimed on the return is 150% or more of the correct amount, and
2) You underpaid your tax by at least $1,000 because of these overstatements.

What Is Fair Market Value?

Fair market value generally is the price that property would sell for on the open market. It is the price that would be agreed on between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the facts. It takes into account many factors that affect the value of property on the *date of contribution* (discussed later).

For example, if you give used clothing to the Salvation Army, the fair market value would be the price that typical buyers actually pay for clothing of this age, condition, style, and use. Usually such items are worth far less than what you paid for them.

In making and supporting the valuation of property given to a qualified organization, all relevant factors affecting its value must be considered. These include the cost or selling price of the item, sales of comparable properties, replacement cost, opinions of experts, and the valuation date (date of contribution).

If you put restrictions on the use of property you donate, the fair market value must reflect that restriction. For example, you donate land and restrict its use to agricultural purposes. You must value the land at its value for agricultural purposes, even though it would have a higher fair market value if it were not restricted.

Cost or Selling Price of the Donated Property

The cost of the property or the actual selling price may be the best indication of its fair market value. For this to be considered:

1) The purchase or sale must take place close to the valuation date in an open market,
2) The purchase or sale must be at "arm's length,"
3) The buyer and seller must have known of all relevant facts,
4) The buyer and seller did not have to act, and
5) The market did not change between the date of purchase or sale and the valuation date.

Example. Tom Morgan, who was not a dealer in gems, bought an assortment of gems for $6,000 from a promoter. The promoter claimed that the price was "wholesale" even though he and other dealers made similar sales at similar prices to other persons who were not dealers. The promoter said that if Tom kept the gems for over one year and then gave them to charity, Tom could claim a charitable deduction of $15,000, which, according to the promoter, would be the value of the gems at the time of contribution. Tom gave the gems to a qualified charity 13 months after buying them, and claimed a charitable deduction of $15,000.

The best evidence of fair market value depends on actual transactions and not on some artificial estimate. The $6,000 charged Tom and others is, therefore, the best evidence of the maximum fair market value of the gems.

The purchase or sale should be reasonably close to the valuation date. Because conditions in the market change, the cost or selling price of property may have less weight if the property were not bought or sold reasonably close to the date of contribution (valuation date).

The terms of the purchase or sale should be considered in determining fair market value if they influenced the price.

Unless you can show that there were unusual circumstances, it is assumed that the increase or decrease in the value of your donated property from your cost has been at a reasonable rate. For time adjustments, an appraiser may consider published price indexes for information on general price trends, building costs, commodity costs, securities, and works of art sold at auction in an arm's-length sale.

Example. Bill Brown bought a painting for $10,000. Thirteen months later he gave it to an art museum, claiming a charitable deduction of $15,000 on his tax return. Bill should include with his return proof that there were unusual circumstances that justify a 50% increase in value for the 13 months he held the property.

An arm's-length offer to buy the property close to the valuation date may help to prove its value if the person making the offer was willing and able to complete the transaction. To rely on an offer, you should be able to show proof of the offer and the specific amount to be paid. Offers to buy property, other than the donated item, will help to determine value if there is reasonable similarity to the donated property.

Sales of Comparable Properties

The sales prices of properties similar to the donated property are often important in determining the fair market value. The weight to be given each sale depends on the following:

1) The degree of similarity between the property sold and the donated property.
2) The time of the sale— whether it was close to the valuation date.
3) The circumstances of the sale— whether it was at arm's length with a knowledgeable buyer and seller, with neither having to act.
4) The conditions of the market in which the sale was made—whether unusually inflated or deflated.

See the discussion of *Comparable sales*, later under *Valuation of Various Kinds of Property*.

Example 1. Mary Black, who was not a book dealer, paid a promoter $10,000 for 500 copies of a single edition of a modern translation of the Bible. The promoter had claimed that the price was considerably less than the "retail" price, and gave Mary a statement that they had a total retail value of $30,000. The promoter ad-

vised Mary that if she kept the Bibles for more than 12 months and then gave them to a qualified organization, she could claim a charitable deduction for the "retail" price of $30,000. Thirteen months later Mary gave all the Bibles to a church that she selected from a list provided by the promoter. At the time of her donation, wholesale dealers were selling similar quantities of Bibles to the general public for $10,000.

The fair market value of the Bibles is $10,000, the price at which similar quantities of Bibles were being sold to others at the time of the contribution.

Example 2. Assume the same facts as in the example above except the promoter gives Mary Black a second option. The promoter said that, if she wants a charitable deduction within a year of purchase, she could buy the 600 Bibles at the "retail" price of $30,000, paying only $10,000 in cash and giving a promissory note for the remaining $20,000. The principal and interest on the note would not be due until the twelfth year. According to the promoter, Mary could then, within a year of purchase, give the Bibles to a qualified organization and claim the full $30,000 retail price as a charitable contribution. She purchases the Bibles under the second option and, 3 months later, gives them to a church, which will use the books for church purposes.

At the time of the gift, the promoter was selling similar lots of Bibles for either $10,000 or $30,000. The difference between the two prices was solely at the discretion of the buyer. The promoter was a willing seller for $10,000. Therefore, the value of Mary's contribution of the Bibles is $10,000, the amount at which similar lots of Bibles could be purchased from the promoter by members of the general public.

Replacement Cost

The cost of buying, building, or manufacturing property similar to the donated item should be considered in determining fair market value. However, there should be a reasonable relationship between the replacement cost and the fair market value.

The replacement cost is the amount it would cost to replace the donated item on the valuation date. Often there is no relationship between the replacement cost and the fair market value. If the supply of the donated property is more or less than the demand for it, the replacement cost becomes less important.

To determine the replacement cost of the donated property, find the "estimated replacement cost new." Then subtract from this figure an amount for depreciation due to the physical condition and obsolescence of the donated property. You should be able to show the relationship between the depreciated replacement cost and the fair market value, as well as how you arrived at the "depreciated replacement cost new."

Opinions of Experts

Generally, the weight given to an expert's opinion on matters such as the authenticity of a coin, a work of art, or the most profitable and best use of a piece of real estate, depends on the knowledge and competence of the expert and the thoroughness with which the opinion is supported by experience and facts. For an expert's opinion to deserve much weight, the facts must support the opinion.

Date of Contribution

It is important to determine the correct *valuation date* (the date of the contribution) because:

1) You must determine the value of your donated property as of that date, and

2) Generally, you must use the value of the property on that date to arrive at the amount of your contribution deduction. For certain exceptions, see *Valuation of Various Kinds of Property*, later in this publication.

Whether you use the cash or accrual method of accounting, the charitable deduction may be taken only in the tax year in which the contribution is actually made. Under certain circumstances, an accrual method corporation may choose to deduct contributions that were not paid during the year if payment is made by the 15th day of the 3rd month following the close of the tax year. For more information, see Publication 542, *Tax Information on Corporations*. Ordinarily, the contribution is made when the transfer of the property takes place. But, see *Donating a Future Interest in Tangible Personal Property*, later in this publication.

Stock. If you deliver, without any conditions, a properly endorsed stock certificate to a qualified organization, or the organization's agent, the time of the contribution is the date of delivery. If the certificate was mailed and received through the regular mail, it is the date of mailing. If you deliver the certificate to a bank or broker acting as your agent, or to the issuing corporation or its agent, for transfer into the name of the organization, the time of the contribution is the date the stock is transferred on the books of the corporation. This, in effect, is the date of delivery to the organization.

Options. If you grant an option to a qualified organization to purchase real property, you have not made a charitable contribution until the organization exercises the option. The amount of the contribution is the excess of the fair market value of the property on the date the option was exercised over the exercise price.

Example. You grant an option to a local university, which is a qualified organization, to purchase real property. Under the option, the university could purchase the property at any time during a 2–year period for $40,000. The fair market value of the property on the date the option was granted was $60,000.

In the following tax year, the university exercises the option. The fair market value of the property on the date the option is exercised is $55,000. Therefore, you have made a charitable contribution of $15,000 ($55,000, fair market value, *minus* $40,000, exercise price) in the tax year the option is exercised.

Reduction for Certain Interest

The amount of a charitable contribution must be reduced for certain interest to the extent necessary to avoid a double deduction of the same amount as an interest deduction and as a charitable contribution. This reduction is necessary if a liability is assumed by the recipient of the contribution (or any other person) or if the property contributed is subject to a liability.

The amount of the contribution must be reduced for interest that has been paid (or is to be paid) by you, is attributable to the liability, and is attributable to any period after the contribution.

Example. On January 4 Ann Green gave real estate to the local university. Her adjusted basis and the fair market value of the property was $10,000. The university agreed to assume Ann's debt of $8,000. Two days before making the gift she prepaid one year's interest of $800 on the debt and will take an interest deduction for that amount. The value of the gift, before subtracting the prepaid interest, is $2,800 ($10,000 − $8,000, the debt, + $800, the prepaid interest). To figure her charitable deduction, she must subtract the $800 interest deduction from the value of the gift. Her contribution deduction is $2,000 ($2,800 − $800).

Bonds. You also must subtract from the fair market value any interest paid (or to be paid) on money borrowed to buy or carry a bond, and that is for any period *before* you made the contribution. However, this reduction is limited to the interest (including bond discount and other items that are the same as interest) receivable on the bond that is for the period before the contribution and that you do not, because of your accounting method, have to include in your income for any tax year. As used here, the term "bond" means any bond, debenture, note, certificate, or other proof of debt.

Gain or Loss from Contributio

Generally, the difference between the fair market value of property you give to a qualifie organization and your basis in the property does not result in a gain or loss to you.

Example. You give to your church stock w a fair market value of $10,000. Your basis in t stock is $20,000. You may not deduct the diff ance as a loss on your income tax return. In addition, your charitable deduction is limited $10,000, the fair market value of the stock.

Exceptions. There are exceptions to the general rule, such as for property on which you had a gain or loss that you were not required report. For example, a donation of an installment obligation to a qualified organization m result in a taxable gain or an allowable loss t you. See *Installment Obligations*, later.

Bargain sale. Another exception is a "barg sale." A bargain sale is a sale or exchange o property to a qualified organization at less th its fair market value, which results in a transa tion that is part charitable contribution and p sale or exchange. A bargain sale may result a taxable gain. For more information, see Pu cation 526, *Charitable Contributions*.

Gifts of Appreciated Property

If you donate property with a fair market value that is greater than your basis (generally your cost) in the property, you may have to subtract all or part of the appreciation (increase in value) from the fair market value when figuring your deduction. The amount of the reduction depends on whether the property is ordinary income property or capital gain property.

Ordinary income property is property the sale of which would result in ordinary income or short-term capital gain to you if sold at fair market value on the date of contribution. Examples of ordinary income property are inventory, a copyright, a literary, musical, or artistic composition given by the creating artist, certain letters and memorandums (discussed later under *Letters and Memorandums*), and capital assets held 6 months or less (one year or less if acquired before June 23, 1984).

The deduction for a gift of ordinary income property is limited to the fair market value of the property minus the amount that would be ordinary income.

Example. You give to your church stock t you held for 3 months. The value of the stoc $1,000, but you paid only $800. Because the $200 would have been a short-term capital gain, your deduction is limited to $800.

Activities equivalent to those of a dealer. your acquisition and contribution activities a equivalent to the activities of a dealer buyin and selling inventory, your donation is treate as ordinary income property (inventory).

Your contribution activities are equivalent the selling activities of a dealer if you buy o

produce property in bulk and distribute it to qualified organizations. Because this treatment applies *only* to charitable contributions, you are not considered to be carrying on a trade or business for any other purposes.

Example 1. Lisa Baker, not a dealer in art, bought for $25,000 a substantial part of the total limited edition of a lithograph print by a well-known artist. After holding the prints for 7 months, Lisa gave them to various art museums. The total fair market value of the prints was $35,000 when they were donated. Because of her bulk purchase and disposition of the prints, Lisa's activities are considered to be equivalent to those of a commercial dealer in art. Her deduction is limited to $25,000 (the fair market value, $35,000, minus the amount that would be ordinary income if she had sold the prints, $10,000).

Example 2. Tom Miller is not a dealer in books. Through a promoter, Tom bought 100 art books for $2,500, or $25 a book, from a company located in a foreign country. The retail price of $100 a book is legally fixed under the law of the foreign country. The promoter claimed that, for income tax purposes, the fair market value of the books is their established retail price in the foreign country. After holding the books for 9 months, Tom gave them to several charities and claimed a $10,000 ($100 a book) charitable deduction on his income tax return. The list price of the books in the foreign country is not enough to support the deduction claimed by Tom.

Because Tom's activities are equivalent to the selling activities of a book dealer, he is treated as having contributed ordinary income property. If the fair market value of the books at the time of the gift is determined to be $3,000, or $30 a book, Tom's deduction is limited to $2,500 (the fair market value, $3,000, minus $500, the amount that would be ordinary income).

However, if the fair market value were determined to be $1,000, or $10 a book, Tom's deduction would be limited to $1,000, the fair market value. This rule applies to any property donated under similar circumstances.

Depreciable property. If you give depreciable or recovery property to a qualified organization, you must reduce its fair market value by the amount of the gain that would be ordinary income, because of the depreciation or Code section 179 deduction taken, if the property had been sold. See Publication 544, *Sales and Other Dispositions of Assets*, for the kinds of property to which this rule applies.

There are special rules for corporations (other than S corporations) that contribute certain kinds of ordinary income property, such as inventory, to public charities or private operating foundations. For more information, see Publication 542, *Tax Information on Corporations*.

Capital gain property is property the sale of which would result in long-term capital gain if you sold it at fair market value on the date of contribution.

The maximum amount of the deduction is usually the fair market value of the property. But an individual must reduce the contribution by 40% of the amount that would be a long-term capital gain if:

1) The contributed capital gain property is ***tangible personal property*** and the charity's use of the property is unrelated to its exempt purpose or function (for example, soon after a painting is given to an educational organization, the organization sells it at auction), or
2) The capital gain property is given to certain private nonoperating foundations.

In addition, if you contribute capital gain property not described in (1) or (2), you may choose to reduce the amount of the contribution by 40% of the increase in value that would be long-term capital gain if the property were sold. This choice may benefit you because of rules on deduction limitations and carryovers to later years.

Qualified appreciated stock. If you contributed any qualified appreciated stock to a private nonoperating foundation after July 18, 1984, you do not have to reduce the contribution according to the rules discussed above. Qualified appreciated stock is any stock of a corporation that is capital gain property and for which, on the date of the contribution, market quotations are readily available on an established securities market. This special rule does not apply if you (including your family) contribute more than 10% of the value of the outstanding stock of a corporation.

For more information on gifts of appreciated property and special limits that may apply, see Publication 526.

Contributions Related to Your Business

If you can deduct only part of your allowable contribution because of the percentage limits, the dollar limits, or the requirements as to the time of payment, you may not deduct the remainder as a business expense.

Example. You give property worth $3,000 to a qualified organization but you can deduct only $4,000 as a charitable contribution because of the various limits and requirements that apply to charitable contributions. You may not deduct the remaining $1,000 as a business expense. However, see *Inventory*, discussed later.

Limits on business expense deductions. The limit on business expense deductions applies only if the contribution or gift is, in fact, a charitable contribution. If your transfer of property to a qualified organization is directly related to your business and you make the transfer with reasonable expectation of a financial return equal to the value of the property transferred, the transfer may be an allowable business expense rather than a charitable contribution.

Example. Jim Wilson owns a furniture store. Jim gives furniture and equipment held for sale to the local hospital (a qualified organization). In return, the hospital signs an agreement to provide medical services and facilities for Jim's employees. The transfer is not a charitable contribution. If it otherwise qualifies, the cost of the goods delivered may be deducted as a business expense.

Transfer of land to a governmental body. If you transfer part of your land to a governmental body (state, county, etc.) to get approval of your plans to subdivide the remaining land, you have not made a charitable contribution. However, you may add your basis (generally your cost) in the transferred land to your basis in the remaining land.

Installment Obligations

A gift of installment obligations is deductible. The amount of the deduction is the fair market value of the obligations at the time of the gift *if* the difference between the basis of the obligations and their fair market value is included in income at the time of the gift. Any gain may be ordinary income or capital gain, and any loss may be deducted if the property sold was held for business or investment purposes.

Installment obligations are those received in an installment sale that is reported under the installment method. The gain or loss is considered to result from the sale or exchange of the property on which the obligations were received.

Example. You sold your home 2 years ago for $80,000 realizing a long-term capital gain of $40,000. You did not buy or build a new home and you are not eligible for the one-time exclusion of gain from the sale of a principal residence (your home). Six years ago your home cost you $40,000. When you sold it, you received $25,000 in cash and the buyer's note, secured by a mortgage for the remainder, payable in later years. Last year, before the buyer made any payments on the note, you gave the note and the mortgage to your church. At that time they had a fair market value of $49,000. You may deduct the $49,000 as a charitable contribution. You must also include $21,500 in your income, before the capital gain deduction, figured as follows:

Fair market value of note at time of gift		$49,000
Selling price of home (sec. contract price)	$80,000	
Minus basis (cost of house)	40,000	
Profit to be realized on sale	$40,000	
Percentage of profit, or part of each collection you must report as income (under installment method), $40,000 divided by $80,000	.50%	
Unpaid balance of note	$80,000	
Amount of income you would report if the note were paid in full, 50% of $80,000	27,500	
Adjusted basis of note:		
Excess of unpaid balance of note over amount of income you would report if note were paid in full		27,500
Income realized on disposition (gift) of installment obligation		$21,500

You report the $21,500 as a long-term capital gain, because the gain on the sale of the home was a long-term capital gain.

Letters and Memorandums

Letters, memorandums, or similar property given to a charity by the person who created them or the person for whom they were created, or by the person to whom they were addressed, are considered *ordinary income property*. The deduction is limited to the fair market value of the property minus the amount that would have been ordinary income if the property had been sold at the time of its contribution.

The term ***similar property*** includes a draft of a speech, a manuscript, a research paper, an oral recording of any kind, a transcript of an oral recording, a transcript of an oral interview or dictation, a personal or business diary, or a log or a journal. In addition, a corporate archive, including a corporate charter, office correspondence, a financial record, a drawing, a photograph, or a dispatch is considered to be similar property.

These rules do not apply to such property as a corporate archive, financial record, or correspondence sold or disposed of as part of a going business if there is no significant value separate and apart from its relation to, and use in, the business.

Generally, property is created by the personal efforts of an individual who performs literary, theatrical, musical, artistic, or other work that effectively contributes to creating the property, or by an individual who directs and guides the performance of others.

A letter, memorandum, or similar property that is prepared by personnel who are under

the administrative control of an individual, such as a corporate executive, is considered to have been prepared or produced by the executive, whether or not the material is reviewed by that person.

Government Publications

U.S. Government publications (including the *Congressional Record*) that you get from the government without charge, or below the price at which they are sold to the general public, are considered *ordinary income property*. If you later give these publications to a qualified organization, your deduction is the fair market value minus the amount that would be ordinary income.

If you get, without charge, any government publications from someone who got them without charge, or below the price at which they are sold to the general public, your basis in the publications, for tax purposes, is the same as that of the person who originally got them.

Benefits to Donors

If you expect to receive money or other benefits in return for making a gift to a qualified organization, and the value of the benefit is equal to the value of your gift, you have not made a charitable contribution.

Example. You transfer real estate to a nursing home in return for a promise of permanent care for your father. You have not made a charitable contribution because you have received a valuable consideration (permanent care for your father) for making the gift.

Donating the Use of Your Property

If you let a charitable organization use your property, you may not deduct the rental value of its use. For example, you may not deduct the rental value of the use of your land by a church for a picnic.

Donating a Future Interest in Tangible Personal Property

A future interest is an interest in property that is to begin in use, possession, or enjoyment at some future time. It is not necessary that the interest be designated as a future interest under state law.

When deductible. A gift of a future interest in tangible personal property to a qualified organization may not be deducted until all intervening interests in, and rights to, the actual possession or enjoyment of the property have either expired or are held by someone other than yourself or *related persons* (defined later).

As used here, *tangible personal property* includes a fixture, such as a chandelier, that can be removed from the real property and donated separately.

The amount of the contribution is the value of the future interest when the intervening interests have expired.

Example 1. You agree to lend your collection of rare coins for an exhibit by a nonprofit museum. Under the terms of the agreement, you may take back the collection at any time before your death. At death the collection will pass to the museum, a qualified charitable organization.

Because this collection of rare coins is not held primarily as a medium of exchange and has increased in value as a collector's item, the collection is tangible personal property. A charitable contribution was *not* made at the time it was placed on exhibit.

Example 2. You transferred a painting to your son for your life and then to the local art museum upon your death. If your son irrevocably transfers his interest to a friend in a later year, you may take a charitable deduction in that year, but not sooner. The amount of your deduction is the value of the future interest in the painting in the year your son transfers his interest to his friend.

Related persons include the following:

1) You and the members of your family—this includes only your brothers and sisters, half-brothers and half-sisters, spouse, ancestors (parents, grandparents, etc.), and lineal descendants (children, grandchildren, etc.),
2) You and a corporation in which you own, directly or indirectly, more than 50% in value of the outstanding stock,
3) A trust fiduciary and a corporation of which more than 50% in value of the outstanding stock is owned, directly or indirectly, by or for the trust or by or for the grantor of the trust,
4) The grantor and fiduciary, and the fiduciary and beneficiary, of any trust,
5) The fiduciaries of two different trusts, and the fiduciary and beneficiary of two different trusts, if the same person is the grantor of both trusts,
6) You and an exempt educational or charitable organization that is controlled by you or a member of your family, and
7) You and a partnership in which you are a partner owning, directly or indirectly, more than 50% of the capital interest, or the profits interest.

Indirect ownership of stock. In determining whether you own, directly or indirectly, any of the outstanding stock of a corporation, the following applies:

1) If stock is owned, directly or indirectly, by or for a corporation, partnership, estate, or trust in which you are a shareholder, partner, or beneficiary, you are treated as the owner in proportion to your ownership interest.
2) If stock is owned, directly or indirectly, by or for a member of your family (as defined under *Related persons*), it is considered to be owned by you, and
3) If you and another member of a partnership each own stock in the same corporation, directly or indirectly, you are treated as owning each other's stock. However, this does not apply for stock one of you owns because of the rule in (2).

Stock indirectly owned by a person under (1) is treated as actually owned by that person, for applying (1), (2), or (3). But stock indirectly owned by a person under (2) or (3) is not treated as owned by that person for again applying either (2) or (3) to make another the indirect owner of the stock.

Partial Interest in Property

Generally, no deduction is allowed for a charitable contribution, not made in trust, of less than your entire interest in property. However, this does not apply to a transfer of less than your entire interest if it is a transfer of:

1) A remainder interest in your personal residence or farm,
2) An undivided part of your entire interest in property, or
3) A qualified conservation contribution.

These transfers of a partial interest in property are discussed in Publication 526.

Valuation of a remainder interest in real prop
erty, not transferred in trust. The amount of t
deduction for a donation of a remainder inter
est in real property is the fair market value of
the remainder interest at the time of the contr
bution. Depreciation (figured by the straight l
method) and depletion (figured by the cost d
pletion method) must be considered in deter-
mining the fair market value. This value must
reduced at the rate of 6% a year, or at some
other rate set by the government.

If the remainder interest includes both dep
ciable and nondepreciable property, for exan
ple a house and land, the fair market value
must be allocated between each kind of prop
erty at the time of the contribution. This rule
also applies to a gift of a remainder interest t
includes a property that is part depletable an
part not depletable. Depreciation or depletio
will be taken into account only for the prope
that is subject to depreciation or depletion.

To figure the value of a remainder interest
real property, see section 1.170A-12 of the I
come Tax Regulations.

Undivided part of your entire interest. A con
bution of an undivided part of your entire int
est in property must consist of a part of each
and every substantial interest or right you ow
in the property and must extend over the en
term of your interest in the property. For exa
ple, if you are entitled to the income from ce
tain property for your life (life estate) and yo
contribute 20% of that life estate to a qualifi
organization, you can claim a deduction for
contribution if you do not have any other int
est in the property. To figure the value of a
contribution involving a life estate, see sect
20.2031-7 of the Estate Tax Regulations.

If the only interest you own in property is
remainder interest and you transfer part of t
interest to a qualified organization, see sect
1.170A-12 of the Income Tax Regulations fo
determining the value.

Qualified conservation contribution. A qual
conservation contribution is a contribution
qualified real property interest to a *qualifie*
ganization to be used only for a *conservati*
purposes. These terms are defined in Public
tion 526.

A qualified real property interest is any o
following interests in real property:

1) Your entire interest in real estate other t
a mineral interest (subsurface oil, gas, c
other minerals, and the right of access t
these minerals). However, a contributor
not qualify if you have reduced your "er
real property interest" before you make
contribution by, for example, transferrin
part of your interest to a related person
(a) keep control of more than a mineral
terest in the real estate or (b) to reduce
real estate interest donated.
2) A remainder interest.
3) A restriction (granted in perpetuity, that
granted forever) on how the property m
be used. These restrictions include eas
ments and other interests in real estate
under state property laws, have similar
tures.

Valuation. An interest described in (1) s
be valued in a manner that is consistent w
the type of interest transferred. If you own
of the interest in the property, the fair mar
value of the entire property less the fair m
value of any mineral interest you keep is t
amount of the contribution. If you only ow
remainder interest or an income interest (
estate), or if you transferred a remainder i
est (item (2)), the value should be determi
as previously discussed in this section.

In determining the value of restrictions, you should take into account the selling price, in arm's length transactions, of other properties that have comparable restrictions. If there are no qualified sales, the restrictions are valued indirectly as the difference between the fair market value of the property involved before and after the grant of the restriction.

The fair market value of the property before contribution of the easement or restriction should take into account not only current use but the likelihood that the property, without the restriction, would be developed. You should also consider any zoning, conservation, or historical preservation laws that would restrict development. The granting of an easement may increase, rather than reduce, the value of property, and in such situation no deduction would be allowed.

Example. You own 10 acres of farmland. Similar land in the area has a fair market value of $2,000 an acre. However, land in the general area that is restricted solely to farm use has a fair market value of $1,500 an acre. Your county wants to preserve open space and prevent further development in your area.

You grant to the county an enforceable open space easement in perpetuity on 8 of the 10 acres, restricting its use to farmland. The value of this easement is $4,000, determined as follows:

Fair market value of the property before granting easement:		
$2,000 × 10 acres		$20,000
Fair market value of the property after granting easement:		
$1,500 × 8 acres	$12,000	
$2,000 × 2 acres	4,000	16,000
Value of easement		$ 4,000

If you later transfer in fee your remaining interest in the 8 acres to another qualified organization, you must consider the easement in determining the fair market value of the remaining interest.

Note: Granting an easement on part of your property can affect the value of your remaining property.

Problems in Determining Fair Market Value

There are a number of pitfalls to be avoided in determining the value of donated property. A few of the more common ones follow.

Fixed Formulas, Rules, or Methods

Determining the value of donated property would be a simple matter if the appraiser could rely only on fixed formulas, rules, or methods. Usually it is not that simple. Using such formulas, etc., seldom results in an acceptable determination of fair market value. There is no single formula that always applies when determining the value of property. This is not to say that a valuation is only guesswork. The appraiser must consider all the facts and circumstances connected with the property, such as its desirability, use, and scarcity. For example, donated furniture should not be evaluated at some fixed rate such as 15% of replacement cost new. When the furniture is contributed it may be out of style or in poor condition, therefore having little or no market value. On the other hand, it may be an antique whose value could not be determined by using any formula.

Unusual Market Conditions

The sale price of the property itself in an arm's length transaction in an open market is often the best evidence of its value. When you rely on sales of comparable property, the sales must have been made in an open market. If those sales were made in a market that was artificially supported or stimulated so as not to be truly representative, the prices at which the sales were made will not indicate the fair market value. For example, liquidation sale prices usually do not indicate the fair market value. Also, sales of stock under unusual circumstances, such as sales of small lots, forced sales, and sales in a restricted market, may not represent the fair market value.

Future Events

You may not consider unexpected events happening after your donation of property in making the valuation. You may only consider the facts known at the time of the gift, and those that could be reasonably expected at that time.

Example. You give farmland to a qualified charity. The transfer provides that your mother will have the right to all income and full use of the property for life. Even though your mother dies one week after the transfer, the value of the property on the date it is given is its present value, subject to the life interest as estimated from mortality tables. You may not take a higher deduction because the charity received full use and possession of the land only one week after the transfer.

Careless Selection of Comparable Sales

Using sales of comparable property is an important method for determining the fair market value of donated property. However, the amount of weight given to a sale depends on the degree of similarity between the comparable and the donated properties. The degree of similarity must be close enough so that this sales price would have been given consideration by reasonably well-informed buyers or sellers of the property.

Example. You give a rare old book to your former college. The book is a third edition and is in poor condition because of a missing back cover. You discover that there was a sale for $300, near the valuation date, of a first edition of the book that was in good condition. Although the contents are the same, the books are not at all similar because of the different editions and their physical condition. The sale price of the $300 property would be given little consideration by knowledgeable buyers or sellers.

Using Past Events to Predict the Future

A common error is to rely too much on past events to predict future earnings and fair market value.

Example. You give all your rights in a successful patent to your favorite charity. Your records show that before the valuation date there were three stages in the patent's history of earnings. First, there was rapid growth in earnings when the invention was introduced. Then, there was a period of high earnings when the invention was being exploited. Finally, there was a decline in earnings when competing inventions were introduced. While the entire history of earnings may be relevant in estimating the future earnings, the appraiser must not rely too much on the stage of rapid growth in earnings, or of high earnings. The market conditions at those times do not represent the condition of the market at the valuation date. What is most significant is the *trend of decline* in earnings up to the valuation date.

Valuation of Various Kinds of Property

Following is information on determining the fair market value of ordinary kinds of donated property. For information on records you must keep and appraisals, see *Recordkeeping* and *Appraisals*, later.

Household Goods

The fair market value of used household goods, such as furniture, appliances, and linens, is usually much lower than the price paid when new. Such used property may have little or no market value because of its worn condition. It may be out of style or no longer useful. For these reasons, formulas, such as 15% of the replacement cost new, are not acceptable in determining value.

You should support your valuation with photographs, canceled checks, or receipts from your purchase of the items. Magazine or newspaper articles and photographs that describe the items and statements by the recipients of the items are also useful. None of these items needs to be included with your tax return.

If the property is valuable because it is old or unique, see the discussion under *Paintings, Antiques, Other Objects of Art.*

Used Clothing

Used clothing and other personal items are usually worth far less than the price you paid for them. Valuation of items of clothing does not lend itself to fixed formulas or methods.

You should claim as the value the price that buyers of used items actually pay in used clothing stores, such as consignment or thrift shops.

For valuable furs or very expensive gowns, an appraisal summary may have to be sent with your tax return.

Jewelry and Gems

Jewelry and gems, other than "costume" jewelry, are of such a specialized nature that it is almost always necessary to get an appraisal by a specialized jewelry appraiser. The appraisal should describe, among other things, the style of the jewelry, the cut and setting of the gem, and whether it is now in fashion. If not in fashion, the possibility of having the property redesigned, recut, or reset should be reported in the appraisal. The stone's coloring, weight, cut, brilliance, and flaws should be reported and analyzed. Sentimental personal value has no effect on fair market value. But if the jewelry was owned by a famous person, its value might increase.

Paintings, Antiques, Other Objects of Art

Unless the item being evaluated is minor, your deduction should be supported by a written appraisal from a qualified and reputable source. An example of the information that should be included in appraisals of art objects, paintings in particular, is found later under *Qualified Appraisal.*

Most art appraisers are not experts on all art. More weight will usually be given to an appraisal prepared by an individual specializing in the kind and price range of the art being ap-

praised. Certain art dealers or appraisers specialize, for example, in French old masters, modern art, bronze sculpture, etc. Their opinions on the authenticity and desirability of such art would usually be given more weight than the opinions of more generalized art dealers or appraisers. They can report more recent, comparable sales to support their opinion.

The authenticity of the donated art must be determined by the appraiser. Certificates of authenticity may be useful, but this depends on the genuineness of the certificate and the qualifications of the authenticator.

Important items in the valuation of antiques and art are physical condition and extent of restoration. These have a significant effect on the value and must be fully reported in an appraisal. An antique in damaged condition, or lacking the "original brasses," may be worth much less than a similar piece in excellent condition.

To identify and locate experts on unique, specialized items or collections, you may wish to use the current *Official Museum Directory* of the American Association of Museums. It has both a subject category and geographic index.

The *Encyclopedia of Associations*, Gale Research Company, is another useful starting point, particularly section 5, which describes educational organizations. Section 6 describes cultural organizations. Section 13 describes national hobby and avocational organizations, including various highly specialized private collector groups. It also has an alphabetical and key word index. These books may be available at a state, city, college, or museum library.

To help you locate a qualified appraiser for your donation, you may wish to ask an art historian at a nearby college or the director or curator of a local museum. The yellow pages often list specialized art and antique dealers, auctioneers, and art appraisers. Associations of dealers also may be contacted for guidance.

Collections

So many kinds of hobby collections may be the subject of a charitable donation that it is not practical to discuss them all in this publication. Most common are rare books, autographs, manuscripts, stamps, coins, guns, phonograph records, and natural history items. Many of the elements of valuation that apply to paintings and other objects of art, discussed earlier, also apply to miscellaneous collections.

Reference material. Publications available to help you determine the value of many kinds of collections include catalogs, dealers' price lists, and specialized hobby periodicals. However, these sources are not always reliable indicators of fair market value.

For example, a dealer may sell an item for much less than shown on a price list, particularly after the item has remained unsold for a long time. The price an item sold for in an auction may have been the result of a rigged sale or a mere bidding duel. The appraiser must analyze the reference material, and recognize and make adjustments for misleading entries. If you are donating a valuable collection, you should get an appraisal. If your donation appears to be of little value, you may be able to make a satisfactory valuation using reference materials available at a state, city, college, or museum library. If your local library does not have the necessary material, your librarian can often borrow it from the city or state library systems.

Stamp collections. Most libraries have catalogs or other books that report the publisher's estimate of values. Generally, two price levels are shown for each stamp; the price postmarked, and the price not postmarked. Stamp dealers generally know the value of their merchandise and are able to prepare satisfactory appraisals of valuable collections.

Coin collections. Many catalogs and other reference materials show the writer's or publisher's opinion of the current value of coins. Like many other collectors' items, the value of a coin depends on the demand for it, its age, and its rarity. Another important factor is the coin's condition. For example, there is a great difference in the value of a coin that is in *mint condition* and a similar coin that is only in *good condition*.

Catalogs indicate the physical condition of a coin—mint, uncirculated, extremely fine, very fine, fine, very good, good, fair, or poor—with a different valuation for each category.

Books. The value of books is usually determined by selecting comparable sales and adjusting the prices according to the differences between the comparable sales and the item being evaluated. This is difficult to do and, except for a collection of little value, should be done by a specialized appraiser. Within the general category of literary property, there are dealers who specialize in certain areas, such as Americana, foreign imports, Bibles, and scientific books.

If the collection you are donating is of modest value, not requiring a written appraisal, the following information may help you in determining fair market value.

A book that is very old, or very rare, is not necessarily valuable. There are many books that are very old or rare, but that have little or no market value.

The condition of a book may have a great influence on its value. Collectors are interested in items that are in fine, or at least good condition. When a book has a missing page, a loose binding, tears, stains, or is otherwise in poor condition, its value is greatly lowered.

Some other important factors in the valuation of a book are the kind of binding (leather, cloth, paper), page edges, and illustrations (drawings and photographs). Collectors usually want first editions of books. However, because of changes or additions, other editions are sometimes worth as much as, or more than, the first edition.

Manuscripts, autographs, diaries, and similar items that are handwritten, or at least signed, by famous people, often are in demand and are valuable. The writings of unknowns also may be of value if they are of unusual historical or literary importance. Determining the value of such material is difficult. There may be a great difference in value between two diaries that were kept by a famous person—one kept during childhood and the other during an important period in his or her life. The appraiser determines a value in these cases by applying knowledge and judgment to factors, such as comparable sales and conditions.

Signatures, or sets of signatures, that were cut from letters or other papers, usually have little or no value. But complete sets of the signatures of U.S. Presidents are in demand.

Cars, Boats, and Aircraft

If you are not a dealer in cars, boats, or aircraft, and you give such property to a charitable organization, its fair market value must be determined.

Certain commercial firms and trade organizations publish, for different regions of the country, monthly or seasonal, complete dealer sale prices or dealer-average-prices. These are reported for each make, model, and year of used cars, aircraft, trucks, recreational vehicles, boats. These guides also provide estimates adjusting for unusual equipment, unusual age, and for physical condition. The prices not "official" and these publications are no considered an appraisal of any specific do property. But they do provide clues for ma an appraisal and suggest relative prices fo comparison with current sales and offering your area.

These publications are sometimes availa from the loan officer at a bank, credit unio finance company.

Except for inexpensive small boats, the sion of boats should be based on an appr by a marine surveyor because the physica dition is so critical to the value.

Example. You donate your car to a local school for use by students studying autom repair. Your credit union told you that the book" value of the car is $1,800. However, fore you donated your car, you found that, cause the car was a "clunker" needing extensive repairs, you could not sell it for than $750. You may deduct $750, the true market value of the car.

Inventory

If you donate inventory (property that yo in the course of your business), the fair m value is the price that you would have rec If you had sold the contributed property in market in which you usually sell, at the tim and place of the contribution. For a donati goods in quantity, the fair market value is price for the quantity contributed. The usu market of a manufacturer or other produc the group of wholesalers or other distribut or through whom sales usually are made. ever, if sales are made only at retail, the u market is the retail customer.

If you donate inventory at a time when y reasonably could not expect to get its usu selling price, the value of the gift is not the usual selling price but is the amount that could have sold the property for at the tim the contribution.

Costs and expenses relating to the contri inventory that were incurred in earlier tax and are properly included in the opening tory for the year of the contribution must moved from inventory. In addition, these c and expenses are not to be considered as of the cost of goods sold in determining g income for the year of contribution, inasm they are considered in determining the ba the contribution.

However, any costs or expenses for the tributed inventory, which are incurred in t year of the contribution, that would be pro included in the cost of goods sold, should included in costs of goods sold and are n considered in arriving at the basis for the erty. The treatment is the same for the cu year's deductible expenses and costs for contributed inventory, even though they a includible in the cost of goods sold.

Stocks and Bonds

The value of stocks and bonds is the fa market value of a share or bond on the va ation date (see *Date of Contribution*, earli

Based on selling prices. If there is an acti market for the contributed stocks or bond stock exchange, in an over-the-counter m or elsewhere, the mean (midpoint) of the est and lowest quoted selling prices on th valuation date is the fair market value of a share or bond. For example, if the highes ing price for a share was $11, and the low $9, the mean is $10 ($11 + $9) ÷ 2).

If there were no sales on the valuation date, but there were sales within a reasonable period before and after the valuation date, the fair market value is determined by taking a weighted average of the means between the highest and lowest sales prices on the nearest date before and the nearest date after the valuation date. The average is to be weighted in *inverse* order by the respective number of trading days between the selling dates and the valuation date.

Example. You give stock to a qualified organization. There were no sales of the stock on that day. Sales of the stock nearest the valuation date took place two trading days before the valuation date at a mean selling price of $10 and three trading days after the valuation date at a mean selling price of $15. The fair market value is $12, figured as follows:

$$[(3 \times \$10) + (2 \times \$15)] \div 5 = \$12$$

Stocks or bonds listed on more than one stock exchange are valued based on the prices of the exchange where they are principally dealt in. If these prices are not published in a generally available listing or publication of general circulation and the stocks or bonds are reported on a composite listing of combined exchanges in a publication of general circulation, the composite list is used. See also *Unavailable prices or closely held corporation.*

Based on bid and asked prices. If there were no actual sales within a reasonable period before and after the valuation date, the fair market value is the mean between the bona fide bid and asked prices on the valuation date. If there were no prices available, the value may be determined by taking a weighted average of the means between the bona fide bid and asked prices on the closest trading date before and after the valuation date. Both dates must be within a reasonable period. The average should be weighted in *inverse* order by the respective number of trading days between the bid and asked dates and the valuation date.

Example. Although there were no sales of Blue Corporation stock on the valuation date, bona fide bid and asked prices were available on that date of $14 and $16, respectively. The fair market value is $15, the mean between the bid and asked prices.

If no actual sale prices or bona fide bid and asked prices are available on a date within a reasonable period before the valuation date, but are available on a date within a reasonable period after the valuation date, or vice versa, then the mean between the highest and lowest of such available sale prices, or bid and asked prices, may be taken as the value.

Large blocks of stock. There is a basic economic principle that, when the supply is greater than the demand, prices will be lower. For example, if an unusually large block of stock is to be valued and the market price is based on sales in small quantities, the stock to be valued often is considered to be worth less. On the other hand, market forces may exist that will afford higher prices for large blocks of stock. When the value of a given number of shares is affected by the size of the block, this is known as blockage. There are many factors to be considered in determining the amount of the discount or premium, if any, usually requiring the help of experts specializing in underwriting large quantities of securities, or trading in the securities of the industry of which a particular company may be a part.

Unavailable prices or closely held corporation. If selling prices or bid and asked prices are not available, or if securities of a closely held corporation are involved, the fair market value is to be determined by taking into consideration the following factors:

1) For bonds, the soundness of the security, the interest yield, the date of maturity, and other relevant factors, and
2) For shares of stock, the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors.

Some other relevant factors are the goodwill of the business, the economic outlook in the particular industry, the company's position in the industry, and the value of securities of corporations engaged in the same or similar business. For preferred stock, the most important factors are its yield, dividend coverage, and protection of its liquidation preference.

You should keep complete financial and other information on which the valuation is based, including copies of reports of examinations of the company, made on or close to the valuation date, by accountants, engineers, or any technical experts.

Restricted securities. A company often has a class of stock that cannot be traded publicly. The reason that the stock cannot be traded may be due to various restrictions placed on the stock by the Securities and Exchange Commission, or to restrictions placed on the stock by the corporate charter or a trust agreement. These restricted securities usually are traded at a discount in relation to freely traded securities.

All relevant factors, including those in the previous discussion, must be considered to arrive at the fair market value of restricted securities. Additional factors that must be considered include: the resale provisions found in the restriction agreements, the relative negotiating strengths of the buyer and seller, and the market experience of freely traded securities of the same class as the restricted securities.

Real Estate

Because each piece of real estate is unique and its valuation is complicated, a detailed appraisal by a professional appraiser is necessary.

The appraiser must be thoroughly trained in the application of appraisal principles and theory. There will be instances when the opinions of equally qualified appraisers may carry unequal weight. One appraiser may have a better personal knowledge of local business conditions by having participated in sales and purchases, or having actually bought and sold comparable properties, on or about the date of appraisal by or near the property to be appraised.

Essential in any appraisal report is a complete description of the property, such as street address, legal description, lot and block number, as well as physical features, condition, and dimensions. The use to which the property is put, zoning and permitted uses, and its potential use for other higher and better uses are also relevant.

Usual valuation methods. In general, there are three main approaches to the valuation of real estate. Each of those approaches is important enough to warrant an individual discussion. It should be recognized that an appraisal may require a combined use of two or three methods rather than one method only.

1. Comparable sales

The comparable sales method compares the donated property with several similar properties that have been sold. The sales prices, after adjustments for differences in date of sale, size, condition, and location, would then indicate the estimated fair market value of the donated property.

If the comparable sales method is used to determine the value of *unimproved real property* (land without significant buildings, structures, or any other improvements that add to its value), the appraiser should consider the following factors when comparing the potential comparable property and the donated property:

1) Location, size, zoning or use restrictions,
2) Accessibility and road frontage, available utilities and water rights,
3) Riparian rights (right of access to and use of the water by owners of land on the bank of a river), existing easements, rights of way, leases, etc.,
4) Soil characteristics, vegetative cover, status of mineral rights, and
5) Other factors affecting value.

In addition, the names of the buyer and seller, the deed book and page number, the date of sale, sale price, property description, amount and terms of mortgages, property surveys, the assessed value, tax rate, and the assessor's appraised fair market value of the comparable properties should be indicated.

The comparable sale price must be adjusted to account for differences between the sale property and the donated property. Because differences of opinion may arise between appraisers as to the degree of comparability and the amount of the adjustment considered necessary for comparison purposes, an appraiser should document each item of adjustment.

Only comparable sales having the least adjustments in terms of items and/or total dollar adjustments should be considered as comparable to the donated property.

2. Capitalization of income

This method capitalizes the net income from the property at a rate that represents a fair return on the particular investment at the particular time, considering the risks involved. The key elements are the determination of the income to be capitalized and the rate of capitalization.

3. Replacement cost new or reproduction cost minus observed depreciation

This method alone typically does not result in a determination of fair market value. When used, it generally tends to set the upper limit of value, particularly in periods of rising costs, because it is reasonable to assume that an informed buyer will not pay more for the real estate than it would cost to reproduce a similar property. Of course, this reasoning does not apply if a similar property cannot be created because of location, unusual construction, or some other reason. Generally, this method serves to support the value. When the replacement cost method is applied to *improved realty*, the land and improvements are valued separately.

The replacement cost of a building is figured by recognizing the materials, the quality of workmanship, and the number of square feet or cubic feet in the building. This cost represents the total cost of labor and material, overhead and profit. After the replacement cost has been figured, consideration must be given to the following factors:

1) Physical deterioration—the wear and tear on the building itself,
2) Functional obsolescence—usually in older buildings where, for example, there is inadequate light, plumbing, or heating, where rooms are small or the floor plan is poor, and
3) Economic obsolescence—outside forces causing the whole area to become less desirable.

Interest in a Business

The fair market value of any interest in a business, whether a sole proprietorship or a partnership, is the net amount that a willing buyer would pay for the interest of a willing seller after consideration of all relevant factors. The relevant factors to be considered in valuing the business are:

1) The fair market value of the assets of the business,
2) The prospective earning capacity of the business, based on a review of past and current earnings, and
3) The other factors used in evaluating corporate stock, if they apply.

The value of the goodwill of the business should also be taken into consideration. You should keep complete financial and other information on which the valuation is based, including copies of reports of examinations of the business made, on or close to the valuation date, by accountants, engineers, or any technical experts.

Annuities, Terms for Years, Remainders, and Reversions

The value of these kinds of property is their present value, except in the case of annuities under contracts issued by companies regularly engaged in their sale. The valuation of these commercial annuity contracts and of insurance policies is discussed later under *Certain Life Insurance and Annuity Contracts*. The special rule for *Donating a Future Interest in Tangible Personal Property* is discussed earlier in this publication.

It is usually necessary to refer to actuarial tables to determine your charitable deduction when annuities, income from trust property, or remainder interests are transferred to a charitable organization.

The present value of an annuity, remainder (other than those specified), or reversion that is dependent on the continuation or termination of the life of one person is figured by the use of Table A in section 20.2031–7 of the Estate Tax Regulations. The present value of an annuity, term for years, remainder, or reversion that is dependent on a term certain (definite number of years) is figured by the use of Table B in the above regulations.

The value of a remainder interest in a charitable remainder annuity trust is determined under section 1.664–2 of the Income Tax Regulations. The value of a remainder interest in a charitable remainder unitrust is determined under section 1.664–4 of the Regulations. The value of a remainder interest in a pooled income fund is determined under section 1.642(c)–6 of the Regulations.

If the valuation of the interest depends on the continuation or termination of more than one life, or on a term certain concurrent with one or more lives, a special factor must be used. Many of these factors may be found in, or can be figured with the use of IRS Publications 723C, 723D, and 723E, available for purchase from the Government Printing Office, Washington, DC 20402.

If a special factor is needed for an actual transaction, you may ask for the special factor by writing to the Internal Revenue Service, Associate Chief Counsel (Technical), CC:IND:S, 1111 Constitution Avenue, N.W., Washington, DC 20224. Be sure to include the date of birth of each person, the duration of whose life may affect the value of the interest, and copies of the relevant instruments.

In certain circumstances a charitable deduction may be allowed for the donation of a partial interest in property. See *Partial Interest in Property*, earlier, for more information.

Certain Life Insurance and Annuity Contracts

The value of an annuity contract or a life insurance policy issued by a company regularly engaged in their sale is the amount that company would charge for a comparable contract.

But, if the donee of a life insurance policy may reasonably be expected to cash the policy rather than hold it as an investment, then the fair market value is the cash surrender value rather than the replacement cost.

If an annuity is payable under a combination annuity contract and life insurance policy (for example, a retirement income policy with death benefit) and there was no insurance element when it was transferred to the charity, the policy is treated as an annuity contract.

Personal Services

You may not deduct the value of the *time or services* that you contribute to a qualified organization. For example, if you are a carpenter, you may not deduct the value of the time or services you give to make repairs on a church. Lawyers, doctors, mechanics, artists, etc., may not deduct the value of their donated time or services.

However, you may deduct unreimbursed *out-of-pocket expenses* you pay in giving services to a charitable organization. These include amounts you pay for transportation from your home to the place where you serve. Also, if you use your car, expenses (such as gas and oil) directly related to services you give to the charitable organization are deductible. If you do not deduct the actual car expenses incurred, you may deduct a standard mileage rate of 12 cents a mile.

For more information on out-of-pocket expenses that qualify for a charitable contributions deduction, see Publication 526.

Recordkeeping

If you make charitable contributions there are certain records that you must keep. Information from these records is needed to substantiate deductions claimed on your tax return. The information is also needed to complete Form 8283, *Noncash Charitable Contributions*, which must be attached to your tax return if the total claimed value of contributed property is more than $500. The following discusses the records that you must keep for contributions of property other than money. See Publication 526 for other information on recordkeeping.

Receipts. If you make a charitable contribution of property other than money, you must maintain for each contribution a receipt from the donee organization showing the following information:

1) The name of the donee,
2) The date and location of the contribution, and
3) A description of the property in detail reasonably sufficient under the circumstances. One of the circumstances to be taken into account is the fair market value of the property. Therefore, the greater the value the more detail that is needed.

A letter or other written communication from the donee organization acknowledging receipt of the contribution, showing the date of the contribution, and containing a sufficiently detailed description of the property contributed is considered a receipt. A receipt is not required if the contribution is made in circumstances where it is impractical to obtain a receipt. An example is where you deposit property at a charity's unattended drop site.

Written records. In all cases you must keep r able written records covering each item of d nated property. These records must include following information:

1) The name and address of the donee orga zation to which the contribution was mad
2) The date and location of the contribution.
3) A description of the property in detail reasonably sufficient under the circumstance One of the circumstances to be taken into account is the fair market value of the pro erty. The greater the value the more detai that is needed. For securities include the name of the issuer, the type of security, a whether the security is regularly traded or stock exchange or in an over-the-counter market.
4) The fair market value of the property at th time the contribution was made, the meth used in determining the fair market value and, if an appraisal was used, a copy of t signed report of the appraiser.
5) For contributions of appreciated property show the cost or adjusted basis of the pro erty, the reduction for the ordinary income and long-term capital gain amounts, and t manner of determining the reductions (see *Gifts of Appreciated Property*, earlier).
6) If less than your entire interest in the prop erty is contributed during the tax year, sho the total amount claimed as a deduction f the tax year due to the contribution of the property, the amount claimed in prior year for contributions of other interests in the property, the name and address of each o ganization to which any such contribution was made, the place where any such tang ble property is located or kept, and the name of any person, other than the donee organization, having actual possession of the property.
7) The terms of any agreement or understand ing entered into by or on your behalf that relates to the use, sale, or other disposition the property. This includes, for example, agreements that (a) restrict temporarily or permanently the right of the organization use or dispose of the property, (b) reserve to, or confer upon, anyone, other than the organization, any right to the income from possession of the property, including the right to vote donated securities, to acquire the property by purchase or otherwise, or designate the person having such income, possession, or right to acquire, or (c) earmark donated property for a particular use

Your written records must be reliable. Facts indicating that the written records are reliable include, but are not limited to:

1) The contemporaneous nature of the writing evidencing the contribution.
2) The regularity of your recordkeeping procedures. For example, if you regularly make contemporaneous diary entries stating the amount and date of the donation and the name of the donee organization, your diary would generally be considered a reliable written record.
3) For a contribution of a small amount, the e istence of any written or other evidence fro the donee organization showing receipt of donation, but not meeting the requirements of a receipt as discussed earlier. This evidence includes emblems, buttons, or other

tokens traditionally associated with a charitable organization and regularly given by the organization to persons making cash donations.

Deductions of more than $500. If you make a charitable contribution of property other than money and claim a deduction of more than $500 for the contribution of that item, your written records must include the following information in addition to the 7 items listed previously.

1) The manner of acquisition, such as by purchase, gift, bequest, inheritance, or exchange.
2) The approximate date you acquired the property or, if the property was created, produced, or manufactured by or for you, the approximate date the property was substantially completed.
3) The cost or adjusted basis of the property, other than publicly traded securities held by you for a period of less than 6 months immediately preceding the date the contribution was made. When available this information should be shown for property held for a period of 6 months or more preceding the date the contribution was made.

Form 8283 must be completed and attached to your tax return if you claim a noncash charitable contribution deduction of more than $500. If you do not itemize deductions and you claim a direct charitable deduction for contributions, the total value of the property before applying the percentage determines if you must file Form 8283.

Deductions of more than $5,000. If you made a charitable contribution of property, other than money or publicly traded securities, the claimed value of which is more than $5,000, you must meet the *substantiation requirements*, listed below, to be allowed a charitable contribution deduction for that property. The claimed value is the total claimed or reported value of such item of property and all similar items of property for which charitable contribution deductions are claimed or reported by you for the same tax year, whether or not donated to the same donee.

The phrase *similar items of property* means property of the same generic category or type, such as stamps, coins, lithographs, paintings, photographs, books, nonpublicly traded stock, publicly traded stock, land, or buildings. For example, if you give books to three schools and the books are valued at $2,000, $2,500, and $800, respectively, your claimed value is more than $5,000 for these books. You must meet the substantiation requirements that follow to be allowed a charitable contribution deduction for the books.

Substantiation requirements. These requirements apply to charitable contributions made by an individual, closely held corporation, personal service corporation, partnership, or S corporation. The donor of property, other than nonpublicly traded stock, must:

1) Obtain a qualified appraisal (see *Appraisals*, later) for the property contributed,
2) Attach a fully completed appraisal summary (see *Appraisals*) to the tax return (or information return) on which the deduction for the contribution is first claimed or reported, and
3) Maintain the reliable written records discussed earlier.

For *nonpublicly traded stock*, the claimed value of which is more than $5,000 but not more than $10,000, you must—

1) Attach a partially completed appraisal summary to the tax return (or information return) on which the deduction is first claimed or reported, and
2) Maintain the reliable written records discussed earlier.

Appraisals

Appraisals are not always necessary, particularly for minor items of property. This is also true when the value of the property can easily be determined, such as the prices of securities that are reported daily in the newspapers.

Generally, if the claimed value of an item of donated property, or similar items of property, is more than $5,000, you must get a *qualified appraisal* made by a *qualified appraiser* and you must attach *an appraisal summary* to your tax return. If the value determined by an appraisal is not more than $5,000, you should keep the appraiser's report with your records.

The weight given the appraisal depends on the completeness of the report, the qualifications of the appraiser, and the appraiser's demonstrated knowledge of the donated property. An appraisal must give all the facts on which to base an intelligent judgment of the value of the property.

The appraisal may not be given any weight if:

1) All the factors that apply are not considered,
2) The opinion is not supported with facts, such as purchase cost and comparable sales, or
3) The opinion is not consistent with known facts.

The appraiser's opinion is never more valid than the facts on which it is based; without these facts it is simply a guess.

Membership in professional appraisal or dealer organizations does not automatically establish the appraiser's competency. Nor does the lack of certificates, memberships, etc., automatically disprove the competency of the appraiser.

The opinion of a person claiming to be an expert is not binding on the Internal Revenue Service. All facts associated with the donation may be considered.

Cost of appraisals. You may not take a charitable deduction for fees you pay for appraisals of your donated property. However, they may qualify as a miscellaneous deduction on Schedule A (Form 1040) if they were paid to determine the amount allowable as a charitable contribution.

Qualified Appraisal

A qualified appraisal is an appraisal document that:

1) Relates to an appraisal made not earlier than 60 days prior to the date of contribution of the appraised property, and
2) Is prepared, signed, and dated by a *qualified appraiser* (defined later), and
3) Includes certain information (covered later).

No part of the fee arrangement for a qualified appraisal can be based on a percentage of the appraised value of the property. (If a fee arrangement is based on what is allowed as a deduction, after Internal Revenue Service examination or otherwise, it is treated as a fee based on a percentage of appraised value.) However, this rule does not apply to a fee paid to a generally recognized association that regulates appraisers if:

1) The association is not organized for profit and no part of the net earnings benefit any private shareholder or individual, and
2) The appraiser does not receive any compensation from the association or any other persons for making the appraisal, and
3) The fee arrangement is not based in whole or in part on the amount of the appraised value that is allowed as a deduction after an Internal Revenue Service examination or otherwise.

You must receive the qualified appraisal before the due date (including extensions) of the return on which a charitable contribution deduction is first claimed for the donated property. If the deduction is first claimed on an amended return, the qualified appraisal must be received before the date on which the return is filed.

You must keep the qualified appraisal as long as it may be relevant under the tax law. You do not need to attach it to your tax return. The appraisal summary must be attached to your tax return.

Information included in qualified appraisal. A qualified appraisal must include the following information:

1) A description of the property in sufficient detail for a person who is not generally familiar with the type of property to determine that the property appraised is the property that was (or will be) contributed,
2) The physical condition of any tangible property,
3) The date (or expected date) of contribution,
4) The terms of any agreement or understanding entered into (or expected to be entered into) by or on behalf of the donor (see item 7 of *Written records*, earlier, under *Recordkeeping*),
5) The name, address, and taxpayer identification number of the qualified appraiser and, if the appraiser is a partner, an employee, or an independent contractor engaged by a person other than the donor, the name, address, and taxpayer identification number of the partnership or the person who employs or engages the appraiser,
6) The qualifications of the qualified appraiser who signs the appraisal, including the appraiser's background, experience, education, and any membership in professional appraisal associations,
7) A statement that the appraisal was prepared for income tax purposes,
8) The date (or dates) on which the property was valued,
9) The appraised fair market value on the date (or expected date) of contribution,
10) The method of valuation used to determine fair market value, such as the income approach, comparable sales or market data approach, or the replacement cost less depreciation approach,
11) The specific basis for the valuation, if any, such as any specific comparable sales transaction, and
12) A description of the fee arrangement between the donor and appraiser.

Number of qualified appraisals. A separate qualified appraisal is required for each item of property that is not included in a group of similar items of property. You need only one qualified appraisal for a group of similar items of property contributed in the same tax year, but you may get separate appraisals for each item. A qualified appraisal for a group of similar items must provide all of the required information for each item of similar property. The ap-

praiser, however, may provide a group description for selected items whose total value is not more than $100.

An example of information that should be included in a description of donated property follows. This example deals with the valuation of art objects, but the same kind of detailed information may be given for other property. Appraisal of art objects, paintings in particular, should include:

1) A complete description of the object, indicating the size, the subject matter, the medium, the name of the artist, and approximate date created.
2) A history of the ownership and public exhibitions of the item including proof of authenticity, such as a certificate of authenticity and citations in literature.
3) A photograph of a size and quality fully showing the object, preferably an 8" × 10" black and white or color print, or a 5" × 7" color transparency.
4) The facts on which the appraisal was based, such as—
   a) Sales or analyses of similar works by the artist, particularly on or around the valuation date,
   b) For living artists, prices in dealers' catalogs of the artist's works,
   c) The state of the art market at the time of valuation, particularly with respect to the specific artist, school, or price range.

Appraisal Summary

For a contribution of property, the claimed value of which is more than $5,000, to be allowed as a deduction you must attach a fully completed appraisal summary to your tax return. Only a partially completed appraisal summary is required for contributions of nonpublicly traded stock if its claimed value is not more than $10,000.

Form 8283. Section B of Form 8283 is the appraisal summary. You must complete and attach the form to your return. If you fail to attach the form, the Service may request that you submit it within 90 days of the request. If you comply, the deduction will not be disallowed because of the failure if the failure was a good faith omission.

A separate Form 8283 for each item of contributed property must be attached to the return. If you contribute similar items of property to the same donee organization, you need attach only one Form 8283 for those items. If you contribute similar items of property to more than one donee organization, you must attach a separate form for each donee.

The following is a brief description of the appraisal summary. See the Form 8283 instructions for more information.

Part I, Donee Acknowledgement, is completed by the charitable organization. This part must be signed by an official authorized to sign the tax or information returns of the donee organization, or by a person authorized by such an official to sign Form 8283. The signature does not indicate agreement with the appraised value of the property. It represents acknowledgement of receipt of the property on the date specified on the form. It also acknowledges that the organization understands its information reporting requirements if it disposes of the property in any way within 2 years after the date of receipt. In this situation, the organization must file Form 8282, *Donee Information Return,* and send you a copy of that form.

After completing Part I of Schedule B (Form 8283) the donee organization will return the form to you. You may then complete the information needed.

Part II, Information on Donated Property, is completed by you or the appraiser. The information needed for this part should come from the qualified appraisal and your written records.

Part III, Certification of Appraiser, is completed by the appraiser of the property. This section must be completed for the individual to be considered a qualified appraiser.

Qualified Appraiser

An individual must complete Part III of Section B (Form 8283), which contains a declaration that must be made for the individual to be considered a qualified appraiser. More than one appraiser may appraise the property, provided that each complies with the requirements, including signing the qualified appraisal and appraisal summary.

Excluded individuals. The following persons cannot be qualified appraisers with respect to particular property—

1) The donor of the property.
2) The donee of the property.
3) A party to the transaction in which the donor acquired the property being appraised, unless the property is donated within 2 months of the date of acquisition and its appraised value does not exceed its acquisition price. This applies to the person who sold, exchanged, or gave the property to the donor, or any person who acted as an agent for the transferor or donor in such transaction.
4) Any person employed by, or related under section 267(b) of the Internal Revenue Code to any of the above persons. For example, if the donor acquired a painting from an art dealer, neither the dealer nor persons employed by the dealer can be qualified appraisers for that painting.
5) Any person whose relationship to any of the above persons would cause a reasonable person to question the independence of such appraiser. For example, an appraiser regularly used by the donee who does not perform a substantial number of appraisals for other persons, has a relationship to the donee that is similar to that of an employee and cannot be a qualified appraiser for property contributed to the donee.

A person who completes the appraisal summary and who is not an excluded individual is not a qualified appraiser for a particular donation if the donor had knowledge of facts that would cause a reasonable person to expect the appraiser to falsely overstate the value of the donated property. For example, a donor makes an agreement with the appraiser that the property will be valued at more than its fair market value. The appraiser is not a qualified appraiser for the donation.

Penalties. Any appraiser who falsely or fraudulently overstates the value of property described in a qualified appraisal or appraisal summary that the appraiser has signed may be subject to (1) a civil penalty for aiding and abetting an understatement of tax liability, and (2) having his or her appraisals disregarded.

Internal Revenue Service Review of Appraisals

In reviewing an income tax return, the Service may accept the claimed value of the donated property, based on information or appraisals sent with the return. Or the Service may make its own determination of fair market value. In either case, the Service may:

1) Contact the taxpayer to get more information,
2) Refer the valuation problem to a Service appraiser or valuation specialist,
3) Refer the issue to the Commissioner's Art Advisory Panel. This is a 12 member group of dealers and museum directors who review and recommend acceptance or adjustment of taxpayers' claimed values for major paintings, sculptures, or antiques, or
4) Contract with an independent dealer, scholar, or appraiser to appraise the property. (This may be done by the Service when the objects require appraisers of highly specialized experience and knowledge.)

The Service is responsible for reviewing appraisals, but it is not responsible for making them. Supporting the fair market value listed on your return is your responsibility.

The Service does not give recognition to any appraiser or organization of appraisers and does not accept their appraisals without question.

The Service does not approve valuations or appraisals before the actual filing of the tax return to which the appraisal applies. In addition the Service does not issue advance rulings approving or disapproving such appraisals.

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Internal Revenue Service

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Charitable Contributions

For use in preparing
1985 Returns

Introduction

A charitable contribution is a contribution or gift to, or for the use of, a qualified organization. If you itemize deductions you may deduct charitable contributions to qualified organizations on Schedule A (Form 1040). Even if you do not itemize your deductions, for 1985 you may take a deduction for a part of your contributions to qualified organizations on line 34a of Form 1040, or line 4 of Form 1040EZ, or line 16d of Form 1040A. See *Deduction for Non-Itemizers*, later.

When Deductible

To deduct your contributions, you must make them in cash or other property before the close of your tax year. This applies whether you use the cash or accrual method of accounting.

Usually you make a contribution at the time of its unconditional delivery. For example, a check that you mail to a charity is considered delivered on the date you mail it. If you use a pay-by-phone account, the date reported on the statement of the financial institution showing when payment was made is the date of payment.

The gift to a charity of a property endorsed stock certificate is completed on the date of mailing or other delivery to the charity or to the charity's agent. However, if you give a stock certificate to your agent or to the issuing corporation for transfer to the name of the charity, your gift is not completed until the date the stock is transferred on the books of the corporation.

If you issue and deliver a promissory note to a charitable organization as a contribution, it is not a contribution until you make the note payments. Similarly, if you grant an option to buy real property at a bargain price to a charitable organization, no deduction is allowed until the organization exercises the option.

Contributions charged on your bank credit card are deductible in the year you make the charge. A deduction is also allowed if you borrow funds from a third party and use these funds to make the contribution.

Qualified Organizations

Any organization can tell you if it is a qualified organization. You may deduct a contribution you made to, or for the use of, the following qualified organizations.

A state, a U.S. possession (including Puerto Rico), a political subdivision of a state or possession, the United States, or the District of Columbia, if the contribution is made for public purposes only. An Indian tribal government and any of its subdivisions that are recognized by the Secretary of the Treasury as performing substantial government functions will be treated as a state for purposes of the charitable contributions deduction.

A community chest, corporation, trust, fund, or foundation organized or created in or under the laws of the United States, any state, the District of Columbia, or any possession of the United States. The organization must be organized and operated only for charitable, religious, educational, scientific, or literary purposes. It may also be for the prevention of cruelty to children or animals. Certain organizations that foster national or international amateur sports competition are also included.

Examples of these kinds of organizations include:

- Nonprofit hospitals and medical research organizations,
- Churches, synagogues, or other religious organizations, and
- Most nonprofit educational organizations.

A war veterans organization, including posts auxiliaries, trusts, or foundations organized in the United States or its possessions.

A nonprofit volunteer fire company.

A civil defense organization created under federal, state, or local law. This includes unreimbursed expenses of civil defense volunteers if the expenses are directly connected with the volunteer services.

A domestic fraternal society operating under the lodge system, if the contribution is to be used only for charitable, religious, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

A nonprofit cemetery company, if the funds can be used only for the perpetual care of the cemetery as a whole, and not for a particular lot or mausoleum crypt.

A nonprofit day care center beginning in 1985, if substantially all the child care provided is to enable individuals to be gainfully employed and the services are available to the general public.

Deductible Contributions

Generally, you may deduct your contributions of money or property that you make to, or for the use of, qualified organizations. If you give property to a qualified organization, you generally may deduct the fair market value of the property at the time of the contribution. See *Gifts of Property*, later.

Your deduction for charitable contributions is limited to 50% of your adjusted gross income, but in some cases 20% and 30% limits may apply. See *Limit on Deductions*, later.

Benefits received. You may deduct a contribution only if the value of the contribution is more than the value of any benefit or privilege you may receive. If you pay more than fair market value to a qualified organization for merchandise, goods, or services, the amount you paid that is more than the value of the item may be a charitable contribution.

Example. You pay $20 for a box lunch at a church picnic. If the lunch, plus any entertainment or other services provided, has a fair market value of $5.50, the excess paid, $14.50, is a contribution to the church if all the proceeds of the picnic go to the church.

Benefit performances, etc. If you pay more than fair market value to a qualified organization for charity balls, banquets, shows, or sporting events, etc., you may deduct only the amount that is more than the value of the privileges or other benefits you received.

If there is an established charge for the event, that charge will determine the value of your benefit. If there is no set charge for an event, only that part of your payment that is more than the reasonable value of your benefit is a gift. Whether you use the tickets or other privileges has no effect on the amount you may deduct.

The fact that the amount shown on a ticket or other evidence of payment indicates it is a "contribution" does not mean you may deduct the entire amount. If the ticket shows the price of admission and the amount of the gift, you can deduct the gift amount.

Example. You pay $20 to see a special showing of a movie for the benefit of a qualified organization. Printed on the ticket is "Contribution—$20." If the regular price for the movie is $4, you have made a contribution of $16.

Contributions made by third parties to a pension plan trust established by an exempt organization for the benefit of its employees are deductible by the donors.

Cost and upkeep of uniforms. You may deduct the cost and upkeep of uniforms that are not suitable for every day use but that you must wear while performing donated services for a charitable organization.

Dues, fees, or assessments are deductible if you pay them to qualified organizations. You may deduct only the amount that is more than the value of the benefits you receive. You may not deduct dues, fees, or assessments paid to country clubs and other social organizations.

Student living with you. If you pay the costs of a student who lives in your home, you may deduct up to $50 a school month of the amount you paid. The student may be foreign or American and must be someone who is not your dependent or relative. The student must be a member of your household under a written agreement between you and a qualified organization. The purpose of the agreement must be to provide educational opportunities for the student.

You may deduct up to $50 of your expenses for each full calendar month of your tax year during which the student is:

1) A member of your household, and
2) A full-time student in the 12th or lower grade at a school located in the United States.

A period of 15 or more days in a month is a full calendar month for this purpose.

Depreciation on your home and the fair market value of lodging or any similar item is not considered an amount spent by you. You must actually spend money for the well-being of the student. Amounts you pay for books, tuition, food, clothing, and entertainment of the student qualify for the deduction.

If you are compensated or reimbursed for the costs of having a student living with you, you may not take a deduction for any part of these costs. However, you may be able to take the deduction if you are reimbursed for only an extraordinary or nonrecurring item, such as a hospital bill or vacation trip, that you paid in advance at the request of the student's parents or the sponsoring organization.

You may not deduct the costs of a foreign student living in your home under a mutual exchange program whereby your child will live with a family in a foreign country. If the program is sponsored by a qualified organization that arranges the student exchanges for cultural and educational purposes, you may take a deduction *only* if your contribution exceeds the fair market value of the services you receive.

Out-of-pocket expenses. You may deduct some amounts you pay in giving services to a charitable organization. These include amounts you pay for transportation from your home to the place where you serve. You may deduct reasonable payments for necessary meals and lodging while you are away from home overnight giving your services to a qualified organization. However, you may not deduct the value of your time or services.

You may not deduct your expenses in attending a church convention if you go only as a member of your church rather than as a chosen representative. You may deduct unreimbursed expenses that are directly connected with giving services for your church during the convention.

If you are a chosen representative attending convention of a qualified organization, you may deduct unreimbursed expenses for travel and transportation. You may also deduct a reasonable amount for meals and lodging while away from home overnight in connection with the convention.

You may not deduct personal expenses for sightseeing, fishing parties, theater tickets, or night clubs. You also may not deduct travel, meals and lodging, and other expenses for your spouse or children.

You may not deduct direct contributions to needy individuals. The contributions must be made to a qualified organization and not earmarked for use by a specific person. However, you may deduct reasonable unreimbursed out-of-pocket expenses you spend for underprivileged juveniles selected by a charitable organization to attend athletic events, movies, or dinners. It must be for a qualifying organization whose goal is to reduce juvenile delinquency. Your own similar expenses are not deductible.

Car expenses. You may deduct unreimbursed out-of-pocket expenses directly related to services you give to a charitable organization, such as expenses for gas and oil for your car. You may not deduct general repair and maintenance expenses.

If you do not want to deduct your actual expenses, you may use a standard rate of 12 cents a mile to figure your contribution.

In either case, you may deduct parking fees and tolls. You may not deduct depreciation and insurance.

Daily allowances (per diem). If you provide services for a charitable organization and receive a daily allowance to cover reasonable travel expenses, including meals and lodging while away from home overnight, include in income the amount that is more than your actual travel expenses. You may deduct your necessary travel expenses that are more than the allowance.

Foster parents. If you are a foster parent and have no profit motive in providing foster care for children, you may deduct unreimbursed expenses you pay to provide foster care for children placed in your home by a charitable organization. The unreimbursed expenses must be amounts spent to provide support for the child. For more information on foster children, see Publication 901, *Exemptions*.

Permanent diaconate programs. You may deduct as a charitable contribution any unreimbursed expenses you have while in a permanent diaconate program established by your church. These expenses include the cost of vestments, books, and transportation required in order to serve in the program as either a deacon candidate or as an ordained deacon.

Nondeductible Contributions

Contributions to the following organizations are not deductible.

- Chambers of commerce and other business leagues or organizations,
- Civic leagues,
- Communist organizations,
- International organizations, and
- Social clubs.

Appraisal fees that you pay to find the fair market value of donated property are not deductible as contributions. You may claim them as miscellaneous deductions on Schedule A (Form 1040).

Blood donated to the Red Cross or to other blood banks is not deductible.

Contributions to fraternal societies are not deductible if they are used to pay sickness or burial expenses of members.

Contributions made directly to a foreign organization are not deductible. However, you may deduct contributions to a U.S. organization that transfers funds to a charitable foreign organization if the U.S. organization controls the use of the funds or if the foreign organization is only an administrative arm of the U.S. organization.

Exception. Under an income tax treaty with Canada, you may be able to deduct contributions to certain Canadian charitable organizations under an old treaty or, beginning in 1986, under a new treaty. A new Canadian income tax treaty is effective for tax years beginning on or after January 1, 1985. However, under a provision in the new treaty, for tax years beginning in 1985 you may figure your charitable contributions under the old treaty rules or the new treaty rules, whichever are more advantageous.

Under the old treaty, in addition to being subject to the limits for U.S. charitable contributions, the charitable contributions to Canadian organizations may not be more than the amount that would be allowed as a deduction under Canadian income tax law. Figure your deduction as though your Canadian source adjusted gross income was your only income.

Under the new treaty, the charitable contributions (other than charitable contributions to a college or university at which you or a member of your family is or was enrolled) are subject to the U.S. percentage limits on charitable contributions applied to your Canadian source income.

Canadian organizations must meet the qualifications that U.S. charitable organizations must meet. The organization can tell you if it qualifies for deductible charitable contributions. Or you can find out by writing to the Foreign Operations District, FOD 8, Internal Revenue Service, Washington, DC 20225.

See Publication 597, *Information on United States-Canada Income Tax Treaty*, for an example of how to figure your deduction.

Contributions to political parties and candidates are not deductible as charitable contributions. You may take them as a tax credit subject to certain limits. See Publication 985, *Voluntary Tax Methods to Help Finance Political Campaigns*.

Contributions used to influence the general public on legislative matters, elections, or referenda are not deductible. Even if an organization is a qualified organization, no deduction is allowed for contributions to the organization that are earmarked for use in, or in connection with, attempting to influence legislation.

A contribution of the right to use property, such as a rent-free lease, is not deductible because it is considered a contribution of less than your entire interest in the property. However, see later discussions on *Partial interest in property* and *Qualified Conservation Contribution*.

Example. You donate the rent-free use of the top floor of your 10-story office building to a charitable organization. This is considered a partial interest in property. You may not take a charitable deduction.

Dues to labor unions are not deductible as charitable contributions. You may deduct them as an employee expense. See Publication 529, *Miscellaneous Deductions*.

Contributions to a state bar by members and other donors are not deductible. Membership dues that apply to all members of the bar as a condition of membership are deductible as business expenses.

Payments to a hospital for care of particular patients or for services provided to those patients are not deductible as contributions even if the hospital is operated by a city, state, or qualified organization.

Pre-adoption expenses of keeping a child in your home before the child is adopted may not be deducted as a contribution. However, you

may be able to claim an exemption for the child. See Publication 501, *Exemptions*.

Raffles, bingo, etc. You may not deduct as charitable contributions amounts you pay to buy raffle tickets or to play bingo or other games of chance. They are gambling losses, which may be deducted only to the extent of gambling gains.

"Sustainer's gift" to retirement home. A sustainer's gift to an amount paid when a person is admitted to a retirement home that is operated by a qualified organization. It entitles the person to live in an apartment, the size of which depends upon the amount of the gift. This gift is not a charitable contribution.

Tuition, or amounts you pay instead of tuition, are not deductible as contributions, even if they are paid for children who attend parochial schools.

A fixed amount, designated as a donation, that is required in addition to the tuition fee as a condition of enrollment in a private school is not deductible.

Tax value of your time or services that you contribute to a qualified organization is not deductible.

Gifts of Property

If you donate property to a qualified organization, you generally may deduct the fair market value of the property at the time of the contribution. However, if the property has increased in value, you may have to make some adjustments. See *Gifts of Property That Have Increased in Value*, later.

For information about the records you must keep and the information you must furnish with your return if you donate property, see *Recordkeeping and How to Report*, later.

Fair market value (FMV) is the price at which property would change hands between a willing buyer and a willing seller, neither being required to buy or sell, and both having reasonable knowledge of all the necessary facts.

For more information on determining fair market value, see Publication 561, *Determining the Value of Donated Property*.

If you contribute a large number of the same item, fair market value is the price at which comparable numbers of the item are being sold.

Example. You purchase 500 bibles for $1,000. The retail value of these bibles is $3,000. If you contribute these bibles to a qualified organization, you may claim a deduction only for the price at which similar numbers of the same bible are currently being sold. Your charitable contribution would be $1,000, unless you could show that similar numbers of that bible at the time of the contribution were selling at a different price.

Used clothing or furniture. Generally, the fair market value of used clothing and furniture is far less than its original cost.

For used clothing, you should claim as the value the price that buyers of used items actually pay in used clothing stores, such as consignment or thrift shops.

See Publication 561 for information on the valuation of household goods such as furniture, appliances, and linens.

Cars, boats, and aircraft. If you are not a dealer in cars, boats, or aircraft, and you give such property to a charitable organization, its fair market value must be determined.

Certain commercial firms and trade organizations publish, for different regions of the country, monthly or seasonal, complete dealer sale prices or dealer-average-prices. These are reported for each make, model, and year of used cars, aircraft, trucks, recreational vehicles, and boats. These guides also provide estimates for adjusting for unusual equipment, unusual mileage, and for physical condition. The prices are not "official" and these publications are not considered an appraisal of any specific donated property. But they do provide clues for making an appraisal and suggest relative prices for comparison with current sales and offerings in your area.

These publications are sometimes available from the loan officer at a bank, credit union, or finance company.

Except for inexpensive small boats, the valuation of boats should be based on an appraisal by a marine surveyor because the physical condition is so critical to the value.

Example. You donate your car to a local high school for use by their students studying automobile repair. In the credit union at the place where you work, you are told that the "blue book" value of your car is $1,800. However, your car needs extensive repairs and, after some checking, you find that you would not be able to sell your car for more than $750. You may deduct a charitable contribution, $750, the fair market value of the car.

Property subject to a debt. If you contribute property subject to a debt obligation, you must reduce the fair market value of the property by the amount of the outstanding obligation. Also, the amount of the obligation is considered an amount received on a sale of the property and you may have to divide your basis in the property as discussed later under *Division of Basis*.

Reduction for certain interest. You must deduct from the amount of the contribution any interest paid, or to be paid, by you on a loan secured by property that you donate to a qualified organization. This is to avoid a double deduction, for interest paid and for a charitable contribution. The amount of the reduction is the amount of the interest that is for the liability assumed by the organization and that is for any period after the date the contribution was made.

Partial interest in property. Generally, no deduction is allowed for a charitable contribution, not made by a transfer in trust, of less than your entire interest in property. This does not apply to a contribution of a partial interest in property if that interest is your entire interest in the property, such as an income interest or a remainder interest. A contribution of the right to use property is a contribution of less than your entire interest in that property and is not deductible. In the following situations, however, you may deduct a charitable contribution, not made by a transfer in trust, of less than your entire interest in property.

1) **Undivided part of your entire interest.** A contribution of an undivided part of your entire interest in property must consist of a part of each and every substantial interest or right you own in the property and must extend over the entire term of your interest in the property. For example, if you donate to a qualified organization 20% of an income interest that you have in property, you can deduct the contribution if you have no other interest in the property. If you own 100 acres of land and give 50 acres to a qualified organization, you may deduct the charitable contribution.

2) **Remainder interest in a personal home or farm.** You may take a charitable deduction for a gift, not in trust, to a qualified organization of a remainder interest in a personal home or in a farm. For example, if you transfer a remainder interest in your home to your church, but keep the right to live there for life, you may take a deduction for the value of the remainder interest transferred.

3) **Partial interest that would be deductible if transferred to a trust.** You may take a charitable deduction for an outright transfer of an income interest or a remainder interest that would have been deductible if transferred in trust to a qualified organization. In such a case, you may deduct an amount that would be allowed to you if you had transferred the same property in trust for the charitable organization.

4) **Qualified conservation contribution.** You may deduct a qualified conservation contribution. For information on the kind of contribution, see *Qualified Conservation Contribution*, later.

You may not deduct any other gifts of a partial interest in property.

Valuation of a partial interest in property. The amount of the deduction for a charitable contribution of a partial interest in property is the fair market value of the partial interest at the time of the contribution. If the contribution is of a remainder interest in real property, depreciation (figured on the straight line method) and depletion (figured by cost depletion) of the property must be taken into account in determining the value. This value must further be discounted at 6% a year.

Future interests in tangible personal property. You may deduct the value of a charitable contribution of a future interest in tangible personal property only after all intervening interests in and rights to the actual possession or enjoyment of the property have expired or been turned over to someone other than yourself or a related person or a related organization.

A future interest is any interest that is to begin at some future time, regardless of whether it is designated as a future interest under state law. The term includes situations in which you give tangible personal property to a charitable organization, but have an arrangement (oral or written) with the organization allowing you to keep a right to the use, possession, or enjoyment of the property.

The amount of the deduction is the value of the future interest when you and the related person no longer have an interest in the tangible personal property. When these interests end, the deduction is allowed to you even if there are other outstanding interests that must end before the future interest is realized by the qualified organization.

Example. You transferred a painting in 1990 to your son to use and enjoy for life. When your son dies the painting will go to the local museum of art. If your son irrevocably transfers his life interest to an unrelated person in a later year, you may take a charitable deduction in that year, but not sooner. The amount of your deduction is the value of the future interest in the painting at the time of the transfer to the unrelated person.

Publication 561. For more information on donating a future interest, see Publication 561.

Inventory. If you donate inventory (property that you sell in the course of your business), any costs or expenses you had in earlier taxable years and properly included in the opening inventory for the year of contribution must be removed from opening inventory. They are not a part of the cost of goods sold for purposes of figuring gross income for the year of contribution. Instead they are used to figure the basis of the contribution.

However, any costs or expenses for the contributed property that you had in the year of contribution and that would be properly included in the cost of goods sold should be included in the cost of goods sold for that year. Those properly deductible as business expenses should be deducted in the year paid or

incurred. However, these costs and expenses are not used in arriving at the basis for the contributed property.

Qualified Conservation Contribution

You may deduct as a charitable contribution, not made by a transfer in trust, a qualified conservation contribution even though it is less than your entire interest in the property contributed. A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization only for conservation purposes.

Qualified real property interests. The transfer to a qualified organization of your entire interest in real property other than a qualified mineral interest (subsurface oil, gas, or other minerals and the right of access to such minerals) is a contribution of a qualified real property interest. However, the transfer will not qualify if you have reduced your entire interest in real property before the contribution is made by, for example, transferring part of your interest to a related person to keep control of more than a qualified mineral interest or reduce the real property interest donated.

Other types of transfers that are qualified real property interests are remainder interests in real property and restrictions (granted forever) on how the real property may be used. This restriction would include easements and other interests in real property that are similar under state property laws, such as a restrictive covenant.

Qualified organization. For purposes of a qualified conservation contribution, a qualified organization is:

1) A governmental unit, such as a state or a U.S. possession, or a political subdivision thereof, the United States, or the District of Columbia.
2) A publicly supported charitable, religious, scientific, literary, educational, etc., organization that normally receives a substantial part of its support from a governmental unit or from contributions from the public.
3) An organization that is controlled by a governmental unit or a publicly supported charity, if it is organized and operated exclusively for the benefit of the governmental unit or public charity.

Conservation purposes. Your contribution must be made only for conservation purposes. The *only for* requirement will be satisfied only if the conservation purpose is protected forever. Your contribution must involve legally enforceable restrictions on the interest you kept in the property that prevent the use of that interest inconsistent with the conservation purpose. For example, if you contribute a remainder interest, you cannot use the property in a manner that diminishes the conservation values that are intended to be protected by the contribution. If you retain a qualified mineral interest, this requirement will not be met if at any time the minerals may be removed or extracted by any surface mining method.

However, if the ownership of the surface estate and the mineral interest were separated before June 13, 1979, and are still separated, and the contribution was made after July 18, 1984, the deduction may be allowed if the probability of surface mining on the property is so remote as to be negligible.

Your contribution must satisfy at least one of the following objectives to meet the conservation purposes requirement.

1) **Preservation of land areas.** Conservation purposes include the preservation of land areas for outdoor recreation by, or for the education of, the general public. For example, this would include the preservation of a water area for the use of the public for boating or fishing.
2) **Protection of a natural habitat.** Conservation purposes include the protection of a relatively natural fish, wildlife, or plant habitat. This would include the preservation of a habitat or environment that to some extent has been altered by human activity if the fish, wildlife, or plants exist there in a relatively natural state. Examples include habitats for rare, endangered, or threatened native species of animals, fish, or plants and natural areas that are included in or that contribute to the ecological viability of a local, state, or national park, nature preserve, wildlife refuge, wilderness area, or other similar conservation area. These natural habitats might be protected by easements or other restrictions regarding, for example, the development or use of property that would affect the protected habitat.
3) **Preservation of open space.** Conservation purposes include the preservation of open space, including farmland and forest land. The preservation must yield a significant public benefit and be either for the scenic enjoyment of the general public or under a clearly defined federal, state, or local governmental conservation policy. Visual, not physical, access by the general public to the property may satisfy the scenic enjoyment requirement. Open space easements may qualify even if the property has no significant scenic value if the preservation or conservation is under a governmental policy. Public benefit will be evaluated by considering all the facts and circumstances of the contribution including the uniqueness of the property, the intensity of land development in its vicinity, the consistency of the proposed open space use with governmental programs, and the opportunity for the general public to enjoy the use of the property or to appreciate its scenic value.
4) **Preservation of an historically important land area.** Conservation purposes include the preservation of an historically important land area or a certified historic structure. An historically important land area includes independently significant land areas and historic sites and related land areas, the physical or environmental features of which contribute to the historic or cultural importance and continuing integrity of certified historic structures. The integrity may be protected by restrictions (granted forever) on the development of the related land area. A certified historic structure is any building, structure, or land area that is listed in the National Register, or is located in a registered historic district and is certified by the Secretary of the Interior as being of historic significance to the district. The certification requirements must be met either at the time you made the transfer or on the due date (including extensions) for filing your return for the year in which the transfer was made.

Gifts of Property That Have Increased in Value

If you donate property with a fair market value that is more than your basis in it, you may have to reduce the fair market value by all or part of the increase in value when you figure your deduction. The amount of the reduction depends on whether the property is ordinary income property or capital gain property.

Ordinary income property. Property is ordinary income property if its sale on the date it was contributed would have resulted in ordinary income or in short-term capital gain. Examples of ordinary income property are inventory, works of art created by the donor, manuscripts prepared by the donor, and capital assets held for 6 months or less (one year or less if acquired before June 23, 1984).

The deduction for a gift of ordinary income property is limited to the fair market value less the amount that would be ordinary income if the property were sold at its fair market value.

Example. You donate stock that you held for 5 months to your church. The value of the stock is $1,000, but you paid only $800. Because the $200 of appreciation would be short-term capital gain if you sold the stock, your deduction is limited to $800 (fair market value less the appreciation).

Depreciable property is considered ordinary income property to the extent of any gain that would have been treated as ordinary income because of depreciation had the property been sold. See Publication 544, *Sales and Other Dispositions of Assets*.

Capital gain property is property that would result in long-term capital gain if it were sold at its fair market value on the date of contribution. It includes certain real property and depreciable property used in your trade or business and, generally, held for more than 6 months (more than one year for property acquired before June 23, 1984). For more information, see Publication 544.

You usually may deduct gifts of capital gain property at their fair market value. However, you must reduce the fair market value by 40% of the appreciation if:

1) The capital gain property is contributed to certain private nonoperating foundations,
2) You choose the 50% limit instead of the special 30% limit, discussed later, or
3) The contributed property is tangible personal property that is put to an *unrelated use* by the charity.

The term *unrelated use* means a use that is unrelated to the exempt purpose or function of the charitable organization. For a governmental unit, it means the use of the contributed property for other than exclusively public purposes.

If you make a charitable contribution of tangible personal property to or for the use of a charitable organization or governmental unit, you may treat the property as not being put to an unrelated use by the donee if:

1) You show that the property is not in fact put to an unrelated use by the donee, or
2) At the time of the contribution or at the time the contribution is treated as made, it is reasonable to expect that the property will not be put to an unrelated use by the donee.

Example. If a painting contributed to an educational institution is used by that organization for educational purposes by being placed in its library for display and study by art students, the use is not an unrelated use. But if the painting is sold and the proceeds used by the organization for educational purposes, the use is an unrelated use.

Contributions to private nonoperating foundations. You may deduct the full fair market value of *qualified appreciated stock* you contribute to certain private nonoperating foundations after July 18, 1984. Qualified appreciated stock is any stock of a corporation that is capital gain property and for which market quotations are readily available on an established securities market on the day of the contribution. If you contribute more than 10% of the

value of all of the outstanding stock of a corporation, you may deduct the amount up to 10% at full fair market value. You must reduce the amount in excess of 10% by 40% of the appreciation as discussed under *You usually may deduct* [illegible] *gifts of capital gain property.* For purposes of [illegible] mining the amount of stock you contributed, you are treated as making all contributions made by members of your family. Your family includes your spouse, brothers, sisters, ancestors, and lineal descendents.

You do not have to reduce your charitable contribution if you include the ordinary or capital gain income in your gross income in the same year as the contribution. This may happen when you transfer installment or discount obligations or when you assign income to a charitable organization.

Division of Basis

If you make a gift of less than your entire interest in property or a bargain sale of property to a charitable organization, you must divide your adjusted basis between the fair market value (FMV) of the contributed and noncontributed parts of the property. The rules for gifts of appreciated property are then applied to each part.

Contributions of less than your entire interest in property are discussed earlier under *Partial interest in property.*

You figure the adjusted basis of the contributed part of the property as follows:

$$\frac{\text{Adjusted basis of entire property} \times \text{FMV of contributed part}}{\text{FMV of entire property}}$$

Bargain sales to charity. A bargain sale is a sale or exchange of property to a charity at less than its fair market value. The bargain sale is part sale or exchange of the property and part charitable contribution. For example, if you sell property with a fair market value of $10,000 to a charity for $4,000 and are allowed a deduction for all or part of the $6,000 gift, you have made a bargain sale.

Contribution must result from sale. You must first find out if, ignoring the bargain sale rules, the transaction would result in a charitable contribution. If there is no allowable contribution, the transaction is treated the same as any other sale, and, as in any sale, gain or loss is realized.

To find out if the transaction would result in a deduction you must reduce the fair market value of the property contributed by the sale proceeds. You then reduce the contribution by 100% of the ordinary gain or by 40% of the long-term capital gain, if the reduction applies, that you would have realized if you had sold the entire property at its fair market value at the time of the sale or exchange. However, if because of percentage limits you are not allowed a deduction, the transaction is treated as a regular sale.

If the bargain sale results in an allowable contribution deduction, you must carry over any amounts that are more than the percentage limits (50% and 30%) to the next year. See *Carryovers,* later.

Example 1. You sell ordinary income property with a fair market value of $10,000 to a church for $4,000. Your basis is $4,000 and your adjusted gross income is $30,000. Your contribution from the sale is $6,000 ($10,000 fair market value minus $4,000 selling price). The amount of ordinary income you would have received had you sold the property at its fair market value is $6,000 ($10,000 fair market value minus $4,000 basis) and you also must reduce your charitable contribution by this amount. After you reduce your contribution of $6,000 by the amount of the ordinary income you would have realized ($6,000), you have no charitable contribution deduction.

Example 2. You contribute $15,000 to a church and sell property for $5,000 to a private foundation to which the 30% limit applies (see *Limit on Deductions,* later). The property that you sold had a basis of $2,500 and fair market value of $10,000. Your adjusted gross income for the year is $30,000. Because your allowable contribution to the church, to which the 50% limit applies, equals 50% of $30,000 ($15,000), you are not allowed a deduction in connection with the sale of property to the 30% organization. Therefore, you treat the transaction as a regular sale.

Example 3. You sell long-term capital gain property with a fair market value of $10,000 to a church for $4,000. Your basis in the property is $4,000 and your adjusted gross income is $60,000. Your contribution is $6,000 ($10,000 fair market value minus $4,000 selling price) which, because it is made to a 50% organization, does not have to be reduced. Because you can take a charitable contribution by reason of the bargain sale, you must determine your gain under the bargain sale rules.

Division of gain between sold and contributed parts. Once you have established that the transaction results in a charitable contribution, you must divide the adjusted basis of the entire property between the part of the property sold and the part contributed. You also must divide the ordinary gain and long-term capital gain that would result from a sale of the entire property at fair market value between the part of the property sold and the part contributed.

Figure the amounts for the part of the property sold by multiplying the item involved (adjusted basis, ordinary gain, or long-term capital gain) by a number you figure as follows:

Amount realized on sale (proceeds from sale) divided by the fair market value of the entire property at the time of sale.

Figure the amounts for the part of the property contributed by multiplying the item by a number you figure as follows:

Fair market value of entire property at time of sale minus amount realized on sale (proceeds from sale) divided by the fair market value of the entire property at the time of sale.

Example 4. Assume the facts in Example 3, except that of the $6,000 gain that would result from a sale at fair market value, $4,000 is ordinary income and $2,000 is long-term capital gain. Assume also that you must reduce the amount of the contribution by 40% of the long-term capital gain appreciation.

You must use 40% ($4,000 amount realized divided by $10,000 fair market value) of each item involved for the property sold and 60% ($10,000 fair market value minus $4,000 amount realized divided by $10,000 fair market value) for the property contributed. You divide the gain as follows:

	Entire property	Part sold (40%)	Part contributed (60%)
Fair market value	$10,000	$4,000	$6,000
Adjusted basis	4,000	1,600	2,400
Gain	$ 6,000	$2,400	$3,600
Ordinary income	4,000	1,600	2,400
Long-term gain	$ 2,000	$ 800	$1,200

Figuring gain from bargain sale. A gain from a bargain sale is the difference between the selling price and the adjusted basis for the part of the property sold. Gain from a bargain sale can be long-term capital gain, ordinary income, or a combination of both. No loss is considered sustained, even if the proceeds from the bargain sale are less than the adjusted basis.

In *Example 4,* the gain from the bargain sale is $2,400 ($4,000 selling price − $1,600 basis for part sold), of which $800 is long-term capital gain and $1,600 is ordinary income. You must report the sale part of the transaction on your income tax return.

Figuring charitable contribution in bargain sale. If, in figuring that a transaction results in an allowable charitable contribution, you do not have to reduce the amount of the contribution under the rules in *Gifts of Property That Have Increased in Value,* then the bargain sale division will not affect the amount of the contribution.

In *Example 3,* you have made a charitable contribution of $6,000 ($10,000 fair market value of entire property × 60%).

In figuring that a bargain sale results in a charitable contribution, the amount of the contribution may have to be reduced under the *Gifts of Property That Have Increased in Value* rules. Thus, the bargain sale division will affect the amount of the contribution because it determines the amount of gain on which the reduction is based.

Example 5. Assume the facts in Example 4. You figure your charitable contribution as follows:

FMV of contributed part		$6,000
Reduction in contribution for:		
Ordinary income ($2,400 × 100%)	$2,400	
Capital gain ($1,200 × 40%)	480	2,880
Charitable contribution allowable		$3,120

Bargain sale of property subject to a debt. The amount of any indebtedness, such as a mortgage, on property that you contribute is treated as an amount realized for purposes of the bargain sale division even if the organization does not agree to pay or assume the indebtedness.

Example. You contribute property with a fair market value of $25,000 and an outstanding mortgage of $10,000. Your adjusted basis in the property, which you held for more than one year, is $15,000. You have made a charitable contribution of $15,000 ($25,000 fair market value − $10,000 mortgage). Because the outstanding mortgage is treated as an amount realized, your adjusted basis for figuring gain on the bargain sale is $6,000 [$15,000 adjusted basis of entire property × ($10,000 amount realized ÷ $25,000 fair market value of entire property)]. You would recognize a long-term capital gain of $4,000 ($10,000 amount realized − $6,000 adjusted basis) on the bargain sale of the property.

Charitable Contributions in Trust

No deduction is allowed for the value of an interest in property transferred in trust unless the donor's entire interest is contributed to a qualified organization or unless the interest is an income interest or a remainder interest.

Income interest. A charitable contribution of an income interest in property, made by a transfer in trust, is allowed if the income interest is either a guaranteed annuity interest or a unitrust interest and if the grantor is treated as the owner of the interest.

Remainder interest. A charitable contribution of a remainder interest in trust is allowed if the trust is:

1) A pooled income fund,
2) A charitable remainder annuity trust, or
3) A charitable remainder unitrust.

Limit on Deductions

Your contributions deduction may not be more than 50% of your adjusted gross income for the year (line 33, Form 1040). However, the amount you may deduct will not be reduced by net operating loss carrybacks due to losses you have in later tax years. You may deduct contributions *to* most charitable organizations up to 50% of your adjusted gross income. However, contributions *for the use of* any organization, or contributions to veterans organizations, fraternal societies, and nonprofit cemetery companies, are limited to 30% of your adjusted gross income. Also, there is a 30%-adjusted-gross-income limit that applies to contributions of certain capital gain property to charities to which the 50%-adjusted-gross-income limit applies.

There is a 20%-adjusted-gross-income limit that applies to gifts of long-term capital gain appreciated property to private nonoperating foundations and to charities to which the 30%-adjusted-gross-income limit applies to contributions of other than capital gain property.

If you do not itemize your deductions, there is an additional limit on your contributions deduction. See *Deduction for Nonitemizers*, later.

The 50% limit. The 50% limit applies to contributions to the following organizations:

1) Churches, synagogues, or conventions or associations of churches.
2) Tax-exempt educational organizations with a regular faculty and curriculum and a regular student body attending resident classes.
3) Tax-exempt hospitals and, under certain circumstances, organizations directly engaged in continuous medical research with these hospitals.
4) Organizations that receive substantial support from the United States or any state or their political subdivisions, or from the general public, and that are operated only to hold and administer property for state and municipal colleges and universities.
5) A state, a possession of the United States, or any political subdivision of any of the foregoing, or the United States, or the District of Columbia, if the contribution is made for public purposes only.
6) Organizations exempt as charitable, religious, educational, scientific, or literary and organizations created to prevent cruelty to children or animals or to foster national or international amateur sports competition, but only if no part of its activities provide athletic facilities or equipment. However, athletic facilities and equipment may be provided by an amateur sports organization that is organized and operated primarily to conduct national or international competition in sports or to support and develop amateur athletes for national or international competition in sports. These organizations normally must receive a substantial part of their support, other than income from their exempt activities, from direct or indirect contributions from the general public or from governmental units. The public support received must be from a representative number of persons within the community, not from a few individuals or families.
7) Charitable organizations that normally receive more than one-third of their support from persons other than disqualified persons or from organizations described in (1) through (6), if such charitable organizations receive less than one-third of their support from gross investment income and the excess of unrelated business taxable income over the tax on such income.
8) Most organizations operated or controlled by, and operated for the benefit of, those organizations described in (1) through (7).
9) Private operating foundations.
10) Private foundations that give all the contributions they receive to corporations, trusts, or community chests, funds, or foundations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster certain national or international sports competition, or for the prevention of cruelty to children or animals.
11) A private foundation whose contributions are pooled into a common fund if the foundation would be described in section 509(a)(3) of the Internal Revenue Code but for the right of substantial contributors to name the public charities that receive contributions from the fund. Distributions of income must be made within 2 months following the tax year in which it was realized and corpus must be distributed not later than one year after the donor's death or after the death of the donor's surviving spouse if the spouse can name the recipients of the corpus.

A private operating foundation is an organization that (a) spends at least 85% of the lesser of its adjusted net income or minimum investment return directly to conduct the exempt purpose activities for which it is organized, and (b) meets one of the following tests.

1) At least 85% of its assets must be devoted directly to its exempt purpose or to functionally related businesses, or both.
2) At least 85% of its support must normally be derived from at least five independent exempt organizations and the general public, but not more than 25% from any one exempt organization and normally not more than 50% from gross investment income.
3) At least two-thirds of its minimum investment return is distributed directly to conduct its exempt purpose activities.

A private foundation is generally any organization, other than a public charity, exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code.

The 30% limit. The 30% limit applies to contributions to all qualified organizations, such as veterans organizations, domestic fraternal societies, nonprofit cemeteries, and certain private foundations, that do not qualify for the 50% limit described earlier. Contributions for the use of (in trust for) any charitable organization are also limited to 30% of your adjusted gross income. The organization can tell you whether contributions to it qualify for the 50% or 30% limit.

Special 30% limit on certain capital gain property. Gifts of long-term capital gain property that do not have to be reduced by 40% of the appreciation are limited to 30% of your adjusted gross income. See *You usually may deduct gifts of capital gain property*, earlier. However, you may choose the 50% limit for gifts of 30% capital gain property contributed during the year as discussed later under *The 50% limit may be chosen*.

How to Figure Your Deduction

You consider gifts to charitable organizations that qualify for the 50% limit first when you figure your deduction. You consider gifts to which the 30% limit applies after that and only to the extent of the lesser of 30% of adjusted gross income or 50% of adjusted gross income minus the contributions to which the 50% limit applies, without regard to the special 30% limit. You consider gifts of capital gain property to which the special 30% limit applies after all other gifts except gifts of capital gain property to which the 20% limit applies. You consider gifts of capital gain property to charities to which the 20% limit applies after all other gifts and only to the extent of the lesser of 20% of adjusted gross income or 30% of adjusted gross income minus contributions of capital gain property qualifying for the 30% limit.

Example. Your adjusted gross income is $50,000 for 1985. During the year, you gave to your church $2,000 cash and land with a fair market value of $30,000 and a basis to you of $10,000. You had held the land for investment for more than one year. You also gave $5,000 cash to a private foundation to which the 30% limit applies. Because your allowable contributions to an organization to which the 50% limit applies ($2,000 + $30,000) are more than $25,000 (50% of $50,000), your deductions subject to the 30% limit are not allowable. The $2,000 cash donated to the church is considered first. The deduction for the gift of land does not have to be reduced by the appreciation in value and is limited to $15,000 (30% × $50,000). The unused part ($15,000) may be carried over to later years. Therefore, in 1985 your deduction is limited to $17,000 ($2,000 + $15,000). The $5,000 contribution to the private foundation also may be carried over. See *Carryovers*.

The 50% limit may be chosen for gifts of capital gain property, but you must reduce the fair market value of the property by 40% of the appreciation in value that would be long-term capital gain if the property had been sold. If you make this choice, it applies to all 30% capital gain property. You must make the choice on your original return or on an amended return filed by the due date for filing the original return.

In the previous example, if you chose to disregard the 30% limit, your deduction for 1985 would be $25,000. To disregard the 30% limit, you must choose to reduce the fair market value of the property by 40% of the appreciation in value. Therefore, your deduction for the land would be $22,000 ($30,000 minus 40% of $20,000). You add this amount to the $2,000 cash contributed to the church. You may now deduct $1,000 of the amount donated to the private foundation because the amount applicable to the 50% limit ($24,000) is less than 50% of adjusted gross income. Your total deduction for 1985 is $25,000: $2,000 cash to your church, $22,000 for property donated to your church, and $1,000 cash to the private foundation.

Carryovers. You may carry over your contributions that you are not able to deduct in the current year because they exceed your adjusted gross income limit. Your total contributions deduction for the year to which you carry your contributions cannot exceed 50% of your adjusted gross income for that year. Contributions you carry over are subject to the same percentage limits in the year to which they are carried. For example, contributions subject to the 20% adjusted gross income limit in the year in which they are contributed are 20% limit contributions in the year to which they are carried. You use

your contributions carried over from the earliest year first. Deduct carryover contributions only after deducting all allowable contributions for the current year.

Carryover of contributions to which the 50% limit applies. If your contributions to organizations to which the 50% limit applies are more than 50% of your adjusted gross income, you may deduct the excess in each of the 5 succeeding years until it is used up.

Deduct the amount carried over from the prior year to the extent that it is not more than 50% of the adjusted gross income for the year less the amount of your current year contributions. That is, you may deduct the lesser of the amount of your carryover or 50% of your adjusted gross income for the year less the amount of your current year contributions. Any excess contributions that you may not deduct are carried over to the next year.

Example. You had adjusted gross income of $20,000 in 1985. During the year you contributed $11,000 to your church. You may deduct $10,000 in 1985 (50% of $20,000), and carry over $1,000. In 1986, if you have adjusted gross income of $20,000 and contribute $9,000 or less during the year, you may deduct the entire $1,000 carryover from 1985. However, if you contribute $9,500 during 1986, you may deduct only $500 of your carryover. The $500 balance is carried over to 1987.

Carryover of contributions to which the 30% limit applies. If, in tax years ending after July 18, 1984, your contributions to organizations to which the 30% limit applies are more than 30% of your adjusted gross income, you may deduct the excess in each of the 5 succeeding years until it is used up.

You may deduct the amount of your carryover of 30% limit contributions to the extent your contributions do not exceed the lesser of:

1) The amount of your carryover of 30% limit contributions, or
2) The excess of 50% of your adjusted gross income over the sum of the amount of your current year contributions and the carryover of any contributions to which the 50% limit applies.

Carryover of contributions to which the special 30% limit on certain capital gain property applies. Contributions of certain capital gain property to 50% limit charities are subject to a special 30% limit as discussed earlier. If your contributions exceed the 30% limit, you may deduct the excess in each of 5 succeeding years until it is used up.

Carryover of contributions subject to the special 30% limit are considered after contributions to 30% limit charities.

You may deduct the amount of your carryover of these contributions that is the lesser of:

1) The amount of your carryover of special 30% limit contributions made to 50% charities, or
2) The excess of 90% of your adjusted gross income over the sum of your current contributions and the carryover of any contributions to which the 50% or 30% limit (other than the special 30% limit) applies.

If you carry over contributions of 30% capital gain property and you choose in the next year to disregard the 30% limit and take appreciation into account, you must refigure the carryover by considering the appreciation as if you had made the choice in the previous year and reduce the result by the amount actually deducted in the previous year.

Example. You had an adjusted gross income of $50,000 in 1985. You contributed to a 50% charity 30% capital gain property valued at $20,000 with a basis of $15,000. Your deduction in 1985 is limited to $15,000 (30% of $50,000) and $5,000 is carried over as 30% capital gain property. In 1986, you have an adjusted gross income of $60,000 and you contribute 30% capital gain property valued at $25,000 with a basis of $20,000. You may choose to disregard the 30% rule, but you must take the appreciation into account in 1986 as well as in 1985. The deduction for 1986, before the carryover is considered, is $23,000 ($25,000 − $2,000, 40% of $5,000 appreciation). You refigure the carryover as if you had chosen to consider the appreciation in 1985. Disregarding the 30% rule, your deduction would have been $18,000 ($20,000 − $2,000, 40% of $5,000 appreciation). You actually deducted $15,000 in 1985. Therefore, your refigured carryover is $3,000 ($18,000 − $15,000). Your total deduction in 1986 is $26,000.

Carryover of contributions to which the 20% limit applies. You may carry over in each of the 5 succeeding years excess contributions made in tax years ending after July 18,1984, to which the 20% limit applies. Carryovers of these amounts are considered last. The amount of your carryover is limited in a manner similar to that in the previous discussion of the carryover of 50% and 30% limit contributions.

If you do not itemize deductions in any of the carryover years, you must reduce the carryover by the amount that would have been deductible had you itemized your deductions.

Example. You have a contributions carryover of $500 from 1984 to 1985. If your adjusted gross income is $10,000 for 1985, your deductible contributions for that year are $300, and you do not itemize deductions, you may not carry over the $500 to 1986. If you had itemized your deductions, the total of your contributions paid during 1985 plus carryovers to that year would have fallen below 50% of your adjusted gross income and would be deductible. Therefore, you must consider that your carryover was deducted in 1985.

Deduction for Nonitemizers

You may deduct a part of your charitable contributions even if you do not itemize your deductions. For 1985, your deduction is one-half of your contributions after applying the limits previously discussed.

For 1986, you may deduct 100% of your contributions after applying the limits previously discussed.

Recordkeeping and How to Report

You are required to keep records to prove the amount of the cash and noncash contributions you make during the year. The kind of records you must keep depends on the amount of your contribution and whether it is a cash or noncash contribution.

If you claim the deduction for nonitemizers, you may use Form 1040, Form 1040A, or Form 1040EZ. However, you may only claim the deduction on Form 1040EZ if you give total cash contributions of less than $3,000 to any one organization and no part of your deduction is for contributions of noncash property.

Cash contributions. If you make a charitable contribution of money, you must keep one of the following for each contribution you make:

1) A cancelled check,
2) A receipt (or a letter or other written communication) from the charitable organization showing the name of the organization, the date of the contribution, and the amount of the contribution, or
3) Other reliable written records that include the information in (2). Records may be considered reliable if they are of a contemporaneous nature, if you practice regularity in your recordkeeping, or if, in the case of small donations, you have items such as buttons, tokens, or emblems that are given to contributors.

Form 1040EZ. If you do not itemize your deductions, you may use Form 1040EZ to claim the partial charitable contributions deduction only if the total amount of cash you gave to any one organization is less than $3,000. Enter your deduction on line 4. You may not use Form 1040EZ if you want to claim a deduction for noncash property or claim a deduction based on total cash contributions of $3,000 or more to any one organization.

Form 1040A. If you are claiming the partial charitable contributions deduction for cash contributions, enter the amount you contributed, after applying the limits previously discussed, on line 18a. If you gave cash of $3,000 or more to any one organization, on the line next to 18a, show the organization and the amount you gave. If you made any noncash contributions, see *Noncash contributions.*

Form 1040. If you are claiming the partial charitable contributions deduction for cash contributions, enter the amount you contributed, after applying the limits previously discussed, on line 34b. If you gave cash of $3,000 or more to any one organization, on the dotted line next to line 34b show the organization and the amount you gave. If you made noncash contributions, see *Noncash contributions.*

If you itemize your deductions, on line 15a, Schedule A (Form 1040), enter all of your cash contributions totaling less than $3,000 to any one qualifying organization. If you gave $3,000 or more to any one organization, enter the name of each such organization and the amount you gave on line 15b.

Noncash contributions. The records you must keep and the forms you must file depend on whether you made contributions of property other than money that total:

1) Less than $500,
2) Over $500 but not more than $5,000, or
3) Over $5,000.

Noncash contributions—less than $500. If you make a noncash contribution you must get and keep a receipt from the charitable organization showing:

1) The name of the charitable organization,
2) The date and location of the charitable contribution, and
3) A reasonably detailed description of the property.

A letter or other written communication from the charitable organization acknowledging receipt of the contribution and containing the information in (1), (2), and (3) will serve as a receipt. You are not required to have a receipt where it is impractical to get one. In all cases you must keep reliable written records for each item of donated property.

Your written records must include the following:

1) The name and address of the organization that you contributed to and the date and location of the actual contribution.
2) A description of the property in detail reasonable under the circumstances. For securities, give the name of the issuer, the type of security, and whether or not it is regularly traded on a stock exchange or in an over-the-counter market.

3) The fair market value of the property at the time of the contribution, showing how you figured the fair market value. If it was determined by appraisal, you should also keep a signed copy of the appraisal.
4) The amount of the reduction in the value of the contribution of certain appreciated property, how you figured the reduction, and the basis (or, if applicable, the adjusted basis). If you choose the *special 30% limit on certain capital gain property*, as discussed earlier, you must keep a record showing the years for which you made the choice, contributions for the current year, and carryovers from preceding years to which it applies.
5) The terms of your agreement with the charitable organization, which deals with the use, sale, or other disposition of the property. Write out the terms of any agreement that restricts the charitable organization's use of the property or designates the property for a particular charitable use, such as using donated furniture in the reading room of the organization's library.
6) The amount you claim as a deduction for the tax year as a result of the contribution. If you contribute less than the entire interest in the property during the tax year, you must give the amount claimed as a deduction in any earlier years for contributions of other interests in this property. You must also include the name and address of each organization to which you contributed the other interests, where tangible property is located or kept, and the name of the person who has possession of the property, if it is someone other than the organization to which you contributed.

Noncash contributions over $500 but not more than $5,000. If you claim a deduction for noncash charitable contributions over $500 but not more than $5,000, you must complete Section A of Form 8283, *Noncash Charitable Contributions*, and attach it to your income tax return.

Your written record must include the information listed in items (1) through (6) in the preceding list. You must also keep written records that include the following information:

1) How you acquired the property, for example, by purchase, gift, bequest, inheritance, or exchange.
2) The approximate date you got the property or, if created, produced, or manufactured by or for you, the approximate date the property was substantially completed.
3) The cost or other basis and any adjustments to the basis. This does not apply to publicly traded securities you held for less than 6 months immediately before the date you made the contribution. It does include the cost or other basis of property other than securities held for a period of 6 months or more preceding the date you made the contribution.

Information on acquisition date or cost basis not available. If you are not able to provide information on either the acquisition date or the cost basis of the property and you have a reasonable cause for not being able to provide this information, attach a statement of explanation to your return.

Noncash contributions over $5,000. If you claim a deduction for charitable contributions of property or similar items of property (other than money or publicly traded securities) and the claimed value is over $5,000, you must complete section B of Form 8283. Publicly traded stock is reported in Section A. Your written records must include the information listed in items (1) through (6) under the discussion *Noncash contributions—less than $500*. In addition, you are required to obtain a qualified written appraisal of the donated property from a qualified appraiser. However, in the case of nonpublicly traded stock, see Form 8283. See Publication 561, *Valuation of Donated Property*, for information on qualified appraisals and appraisers.

Form 8282. If an organization sells, exchanges, transfers, or otherwise disposes of property for which it was required to sign a Form 8283 within 2 years after the date of the receipt of the contribution, the organization must file an information return on Form 8282, *Donee Information Return*, with the Internal Revenue Service and send you a copy of the form.

Form 1040EZ. You may not use Form 1040EZ if you want to claim a deduction for noncash property.

Form 1040A. You may claim a partial deduction for charitable contributions of noncash property on Form 1040A. Enter your noncash contributions, after applying the limits previously discussed, on line 16b. If your noncash contributions are over $500, you must attach Form 8283 to your return.

Form 1040. If you claim a partial deduction for charitable contributions of noncash property on Form 1040, enter your noncash contributions, after applying the limits previously discussed, on line 34c. If your noncash contributions are over $500, you must attach Form 8283 to your return.

If you itemize deductions, enter your noncash contributions on line 16, Schedule A (Form 1040). If your noncash contributions are over $500, you must attach Form 8283 to your return.

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Alaska, California, Hawaii, Idaho, Montana, Nevada, Oregon, Utah, Washington	P.O. Box 12626, Fresno, CA 93778
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Puerto Rico—Director's Representative, U.S. Internal Revenue Service, Federal Office Building, Chardon Street, Hato Rey, PR 00918

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SUBJECT: Documenting Art Appraisals for Federal Tax Purposes - Estates, Gifts and Income Tax and the New Tax Changes of the Tax Reform Act of 1984.

Documenting Art Appraisals

I. General Introduction

A. IRS Regulations use the same definition of fair market value for all three tax returns: The price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of the relevant facts. (Retail market is contemplated with exceptions for art dealers and artists' own work.) It presumes cash or terms equivalent to cash.

1. Section 20.2031-1 of the Estate Tax Regulations

a. Valuation of property in general - 20.2031-1(b)

b. Valuation of household and personal effects 20.2031-6

20.2031-6
(a) general rule
(b) substantial amounts of valuable articles
(c) disposition prior to investigation
(d) if an appraisal is involved it must be filed with return (see also sec. 20.2032-1 for timely election of alternate valuation date 6 months after DOD)

2. Section 25.2512-1 of the Gift Tax Regulations Valuation of Property in general

3. Income Tax Regulations

a. Charitable contributions deduction section 1.170A-1
(a) In general
(b) Time of making contribution
(c) Value of a contribution in property

b. Gain or loss on disposition of property section 1.001-1 (a) general rule little case law exists on art appraisals as such.

B. Two Revenue Procedures provide more details and guidelines to making art appraisals.

1. Revenue Procedures 65-19, 1965-2 C.B. 1002, permits, under certain conditions estate tax return values to be based on bonafide sale of tangible personal property through newspaper classified ads or through public auction.

2. Revenue Procedure 66-49, 1966-2 C.B. 1257, provides a procedure to be used as a guideline in making appraisals of donated property for income tax purposes.

   a. Section 1.05 provides that under certain circumstances the recent acquisition cost may be the best evidence of value (see also Pub. 561 (Determining the Value of Donated Property, p. 1)

   b. Revenue Procedure 66-49 provides information and guidelines for "donated" property which actually aid all appraisals for Federal tax purposes.

C. IRS Publication 561, "Determining the Value of Donated Property" provides information on making appraisals for all Federal tax purposes. Copies of all material are included.

II. Information on the Tax Return

A. Estate - valuable personal property with the total value of over $3,000 is to be appraised by an "expert or experts", under oath, accompanied by a written statement of the executor as to the completeness of the itemized list of the property and as to the "disinterested character" and the qualifications of the appraiser or appraisers. (Section 20.2031-6(b) of the Estate Tax Regulations.

III. Tax Reform Act of 1984 (Pub. L. 98-369, 96 Stat. 494)

A. Section 155(a) of that Act, required new regulations regarding charitable contributions. The temporary regulations were published December 31, 1984 in the Federal Register. These temporary regulations supplement the regulations contained in section 1.170A-13.

B. New Substantiation Requirements for Deductions of Charitable Contributions of Property claimed in excess of $5,000.

1. Deductions for certain charitable contributions made after 12/31/84 shall not be allowed unless the donor complies with certain substantiation requirements.

2. These requirements apply to contributions of property (other than money and publicly traded securities) if the the aggregate claimed of such an item (and all similar items) is in excess of $5,000.

Similar items of property - is defined as property of the same generic category or type (coins, stamps, lithographs etc.)

3. Substantiation requirements -

In general, a donor who claims a deduction in excess of $5,000 must -

a. Obtain a qualified appraisal by a qualified appraiser

b. Attach a fully completed appraisal summary to the tax return (Form 8283)

c. Maintain records containing the information required

4. Qualified Appraisal

a. Is a Document that

(1) relates to an appraisal that is made not earlier than 60 days prior to the date of contribution of the property.

(2) is prepared, signed and dated, by a qualified appraiser and

(3) does not involve a prohibited type of appraisal fee.

(4) A qualified appraisal shall include the following information:

(A) A description of the property in sufficient detail for a person who is not generally familiar with the type of property to ascertain that the property that was appraised is the property that was [or will be] contributed;

(B) In the case of tangible property, the physical condition of the property;

(C) The date [or expected date] of contribution to the donee;

(D) The terms of any agreement or understanding entered into [or expected to be entered into] by or on behalf of

the donor which relates to the use,sale, or other disposition of the property contributed, including, for example, the terms of any agreement or understanding which -

Restricts temporarily or permanently the donee's right to use or dispose of the donated property,

Reserves to, or confers upon, anyone [other than the donee organization or an organization participating with the donee organization in cooperative fund-raising] any right to the income from the donated property or to the possession of the property,

(E) The name, address, and taxpayer identification number of the qualified appraiser. [or appraisers] and identification number of employer or partner.

(F) The qualifications of the qualified appraiser who signs the appraisal, including the appraiser's background, experience, eductaion, and membership, if any, in professional appraisal associations;

(G) A statement that the appraisal was prepared for income tax purposes;

(H) The date [or dates] on which the property was valued;

(I) The appraised fair market value of the property on the date [or expected date] of contribution;

(J) The method of valuation used to determine the fair market value, such as the income approach, the market data approach, or the replacement-cost-less-depreciation approach;

(K) The specific basis for the valuation, if any, such as any specific comparable sales transactions; and

(L) A description of the fee arrangement between the donor and appraiser.

(5) Effect of signature of the qualified appraiser. Any appraiser (or appraisers) who falsely or fraudulently overstates the value of the property described in a qualified appraisal or appraisal summary that the appraiser has signed may be subject to a civil penalty under section 6701 for aiding and abetting an understatement of tax liability and consequently may have appraisals disregarded pursuant to 31 U.S.C. 330(c).

(6) Number of qualified appraisals. A separate qualified appraisal is required for each item of property which is not included in a group of similar items of property. Only one qualified appraisal is required for a group of similar items of property contributed in the same taxable year of the donor, although a donor may obtain separate qualified appraisals for each item of property. A qualified appraisal prepared with respect to a group of similar items of property shall provide all the information required for each item of similar property, except that the appraiser may select any items whose aggregate value is appraised at $100 or less for which a group description will suffice.

(7) Time of receipt of qualified appraisal. The qualified appraisal must be received by the donor before the due date [including extensions] of the return on which a deduction is first claimed under section 170 with respect to the donated property, or, in the case of a deduction first claimed on an amended return, the date on which the return is filed.

(8) Retention of qualified appraisal. The donor must retain the qualified appraisal in the donor's records for so long as it may be relevant in the administration of any internal revenue law.

5. Appraisal Summary

a. This is a new form, which was mandated by the Tax Reform Act. It must be:

(1) completed on the appropriate IRS form (8283)

(2) signed and dated by the donee and qualified appraiser

(3) be attached to the doner's return in which a deduction is claimed

b. Information included on appraisal summary:

(1) Name and taxpayer identification number of the donor. (Social Security number if the donor is an individual or employer identification number if the donor is a closely held corporation, personal service corporation, partnership, or S corporation);

(2) A description of the property (in sufficient detail for a person who is not generally familiar with the type of property to ascertain that the property that was appraised is the property that was contributed);

(3) In the case of tangible property, a brief summary of the overall physical condition of the property at the time of the contribution;

(4) The manner of acquisition and the date of acquisition of the property;

(5) The cost or other basis of the property;

(6) The name, address, and taxpayer identification number of the donee;

(7) The date the donee received the property;

(8) The name, address, and taxpayer identification number of the qualified appraiser who signs the appraisal summary;

(9) The appraised fair market value of the property on the date of contribution;

(10) A declaration by the appraiser stating that -

The fee charged for the appraisal is not of a type prohibited by paragraph (c)(6) of this section; and

Appraisals prepared by the appraiser are not being disregarded pursuant to 31 U.S.C. 330(c) on the date the appraisal summary is signed by the appraiser;

c. Signature of the donee:

[The signature of the donee does not represent concurrence in the appraised value of the contributed property. Rather, it represents acknowledgment of receipt of the property described in the appraisal summary on the date specified in the appraisal summary and that the donee understands the information reporting requirements imposed.]

d. Number of appraisal summaries.

A separate appraisal summary for each item of property must be attached to the donor's return. If, during the donor's taxable year, the donor contributes similar items of property to more than one donee, the donor shall attach to the donor's return a separate appraisal summary for each donee. If, however, during the donor's taxable year, a donor contributes similar items of property to the same donee, the donor may attach to the donor's return a single appraisal summary with respect to all similar items of property contributed to the same donee.

e. Manner of acquisition and cost basis information:

If a taxpayer has reasonable cause for being unable to provide the information required, an appropriate explanation should be attached to the appraisal summary. The taxpayer's deduction will not be disallowed simply because of the inability [for reasonable cause] to provide these items of information.

f. At the time the appraisal summary is signed by the donee information on acquisition and appraised value does not have to be included.

g. Failure to attach an appraisal summary:

A charitable deduction will not be disallowed if the donor submits an appraisal summary within 90 days of being requested to do so by the IRS, provided that the failure to attach the summary was in good faith.

6. Qualified Appraiser:

a. Definition

(1) An individual who holds himself or herself to the public as an appraiser

(2) Because of the appraiser's qualifications as described in the appraisal, the appraiser is qualified to make appraisals of the type of property being valued.

(3) The appraiser understands that a false or fraudulent overstatement of the value of the property may subject the appraiser to a civil penalty under section 6701 for aiding and abetting an understatement of tax liability and consequently may have appraisals disregarded pursuant to 31 U.S.C. 330(c).

b. Exception:

Even if the individual complies with the requirements described above, the individual is not a qualified appraiser if the donor had

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knowledge of facts which would cause a reasonable person to expect the appraiser to falsely overstate the value of the donated property.

c. Number of Appraisers.

More than one appraiser may appraise the donated property provided that each appraiser complies with the requirements of this Treasury decision, including signing the qualified appraisal and appraisal summary.

d. Qualified appraiser exclusions:

The following persons cannot be qualified appraisers with respect to particular property:

(1) The donor or the taxpayer who claims or reports a deduction under section 170 for the contribution of the property that is being appraised.

(2) A party to the transaction in which the donor acquired the property being appraised (i.e., the person who sold, exchanged, or gave the property to the donor, or any person who acted as an agent for the transferor or for the donor with respect to such sale, exchange, or gift), unless the property is donated within 2 months of the date of acquisition and its appraised value does not exceed its acquisition price.

(3) The donee of the property.

(4) Any person employed by any of the foregoing persons related to any of the foregoing persons under section 267(b) (e.g., if the donor acquired a painting from an art dealer, neither the art dealer nor persons employed by the dealer can be qualified appraisers with respect to that painting).

(5) Any person whose relationship to any of the persons listed would cause a reasonable person to question the

independence of such appraiser. For example, an appraiser who is regularly used by any person described in this section and who does not perform a substantial number of appraisals for other persons has a relationship to such person that is similar to that of an employee and cannot be a qualified appraiser with respect to the property contributed.

7. Appraisal Fee

a. Generally, no part of the fee arrangement for a qualified appraisal can be based, in effect, on a percentage (or set of percentages) of the appraised value of the property. If a fee arrangement is based in whole or in part on the amount of the appraised value of the property, it shall be treated as a fee based on a percentage of the appraised value of the property. This provision does not apply in certain circumstances to appraisal fees paid to a generally recognized association that regulates appraisers. For example, an appraiser's fee that is subject to reduction by the same percentage as the appraised value may be reduced by the Internal Revenue Service would be treated as a fee that violates this paragraph (c)(6).

b. This section does not apply to a fee paid to a generally recognized association that regulates appraisers provided all of the following requirements are met:

(1) The association is not organized for profit and no part of the net earnings of the association inures to the benefit of any private shareholder or individual (these terms have the same meaning as in section 501(c)), and

(2) The appraiser does not receive any compensation from the association or any other persons for making the appraisal, and

(3) The fee arrangement is not based in whole or in part on the amount of the appraised value of

the donated property, if any, that is allowed as a deduction under section 170 after Internal Revenue Service examination or otherwise.

8. Information Return by Donees

a. The temporary regulations provide that the donee of any charitable deduction property who sells, exchanges, or otherwise disposes of the property within two years after receipt of the property must make an information return, (Form 8282).

Charitable deduction property is defined as any property (other than money or publicly traded securities) contributed after December 31, 1984, with respect to which a donee signs an appraisal summary. A copy of the donee information return must be provided to the donor of the property and retained by the donee.

b. Information required to be provided on return. The information return required by paragraph (a) of this section shall include the following:

(1) The name, address, and employer identification number of the donee;

(2) The name, address and taxpayer identification number of the donor (social security number if the donor is an individual or employer identification number if the donor is a closely held corporation, personal service corporation, partnership, or S corporation).

(3) A description of the property (or portion disposed of) in sufficient detail to identify the charitable deduction property;

(4) The date of the contribution;

(5) The amount received on the disposition;

(6) The date of the disposition; and

(7) Any other information as may be specified by the form or its instructions.

c. Statement to be furnished to donors. Every donee making a return under section 6050L and this section with respect to the disposition of charitable deduction property contributed to the donee shall furnish a copy of the return to the donor of the property.

d. Retention of appraisal summary. The donee shall retain the appraisal summary in the donee's records for so long as it may be relevant in the administration of any internal revenue law.

e. Place and time for filing information returns - Place for filing. The donee information return required by section 6050L and this section shall be filed with the internal revenue service center listed on the return form or its instructions.

Time for filing. The donee information return shall be filed on or before the 90th day after the donee sells, exchanges or otherwise disposes of the charitable deduction property (as described in paragraph (d) of this section).

f. Penalties. For penalties for failure to comply with the requirements of this section, see sections 6652, 6676 and 6678.

9. Modifications of Incorrect Valuation Penalties to Section 6659 of the Internal Revenue Code. 1-1-85 effective

a. * Charitable Contributions:

(1) Elimination of requirement that property be acquired within the last five years to receive penalty.

(2) Valuation Overstatement Defined -

There is a valuation overstatement if the value of any property, or the adjusted basis of any property, claimed in any return is 150 percent or more of the amount determined to be the correct amount of such valuation or adjusted basis.

(3) Amount of Applicable Percentage Penalty - shall be 30%

In the case of any underpayment attributable to a valuation overstatement with respect to charitable deduction property,

(4) Waiver Limitation -

In case of underpayment with respect to charitable deduction property, Secretary may not waive unless determines that -

(a) Claimed value based on qualified appraisal by qualified appraiser

(b) Taxpayer made a good faith investigation of the value of the contributed property

b. * Estate & Gift tax: Sliding scale

(1) If the valuation claimed is the following percent of the correct value	The applicable percentage is:
50% - 66 2/3%	10
40 - 50% (but less than 50%)	20
less than 40%	30

(2) Valuation Understatement Defined:

There is a valuation understatement if the value of any property claimed is 66 2/3% or less of the amount determined

(3) Underpayment must be at least $1,000

(4) Waiver Authority - Secretary may waive all or part if taxpayer shows that there was a reasonable basis, for claimed valuation and made in good faith

c. Appraiser Penalty: Civil penalty under section 6701 for aiding and abetting an understatement of tax liability and consequently may have appraisals disregarded pursuant to Section 330 of Title 31 U.S.C.

1-1-85

(1) After notice and opportunity for a hearing to any appraiser with respect to whom a penalty has been assessed under section 6701(a), the Secretary may -

(a) provide that appraisals by such appraiser shall not have any probative effect in any administrative proceeding before the IRS

(b) bar such appraiser from presenting evidence or testimony in any such proceeding

III. Internal Revenue Services Art Procedures:

A. The Commissioner maintains an Art Advisory Panel to aid the Service in the review of service - selected cases involving taxpayer valuations.

B. The National Office Art Valuation Group is composed of five full time appraisers with backgrounds in art history. They provide the staff support and coordination of the Panel and review appraisals of taxpayer cases on art works not referred to the Panel.

C. All appraisals reviewed in the National Office are sent in from the field. All cases have already been selected for audit.

D. Any taxpayer's appraisal of a single work of art with a claimed value of $20,000 or more must be referred to the Commissioner's Art Advisory Panel.

E. In cases that involve more than one such item, the District Office should refer all such appraisals in excess of $20,000 for sample selection.

F. Items valued at under $20,000 - National Office Art Valuation Group will also provide assistance.

G. Although any single item with a taxpayer's claimed value of $20,000 or more must be referred to the National Office, we do review many items under this figure. Particularly collections which total more than $20,000. We review all kinds of personal property.

Paintings, sculpture, furniture, historical property, African, pre-Columbian, Far Eastern and Asian etc.

IV. Art Advisory Panel:

A. History - In the 1960's art over-valuations were so serious, that the art world realized that Congress might limit the tax deductions for charitable donations. With less incentive for people to give art objects away, fewer objects would be bought and donated.

As a result, the IRS cooperated with art dealers and museum officials to develop a system to monitor appraisals. The Commissioner's Art Advisory Panel, established in 1968, was the result.

B. Over the past eight years the Panel recommended adjustments of $91 million on a total value of $392 million. Annual contribution reductions have ranged from 11 - 58 percent, while estate increases have ranged from 4 - 65 percent.

C. The Panel is composed of previously twelve now twenty-five members including art dealers, museum directors and curators and scholars.

1. The members serve two - year terms.

2. They are not paid, but are reimbursed for travel expenses, meals and lodging, not to exceed $75 per day.

3. Members become Special Government Employees subject to tax and FBI checks. They cannot perform appraisals while serving on the Panel.

4. Panel meetings are held in Washington, D. C.

D. Meetings:

1. General:

a. The panelists typically discuss the fair market value of approximately 250 - 300 art objects per meeting.

2. Specific

a. Panel meetings are closed to the public by determination of the Commissioner that Panel discussions deal with information involved in Federal tax returns.

b. The purpose of Panel meetings is to discuss and make recommendations regarding the acceptability of taxpayer appraisals.

c. Prior to the meetings -

(1) National Office art appraisers send photographs and written materials to the Panelists concerning works of art to be evaluated.

(2) The written materials incorporate information from the taxpayer's appraisal reports as well as results of staff research.

(3) Panelists are sent all available probative information on each work, such as: title, execution date, size, medium and support, physical condition, history of ownership, public exhibitions, and citations in literature.

(4) Panelists are provided information on public and private sales of works by the same artist.

(5) The Panelists are informed of the valuation date and the value claimed on the taxpayer's tax return.

(6) Pre-meeting materials do not identify the taxpayer, appraiser or the tax consequences of adjusting the valuation.

NOTE: Although the taxpayers' names are not identified, the prominence in the art world of many of the works being valued, or discussed as comparable sales, often results in identities of taxpayers and even other art buyers being recognized by the Panelists. This is another reason for the meetings to be closed.

d. To minimize recognition of taxpayers' identities the items are arranged in alphabetical order by the artists' last names or, for non-western art, by category or culture, thus reducing the possibility of recognizing specific collections.

e. The Panel members discuss each work and express a conclusion as to the fair market value on the valuation date.

f. If a Panelist is aware that his/her consideration of an item under discussion could be construed as a conflict of interest, he/she is expected to excuse himself/herself from the discussion.

g. Post Meeting:

(1) After the Panel meeting, the National Office art appraisers prepare valuation reports on the rejected appraisals.

(2) The reports are then returned to the District Office which initiated the referral.

(3) The taxpayer is notified of the Panel decision and provided with a copy of the report and a list of the Panelists.

E. Reconsideration and Appeals Process:

1. If a taxpayer secures additional information to support his valuation, such information if deemed probative by the staff, is submitted to the Panel for reconsideration at a subsequent meeting.

F. Panel Expansion:

1. In 1984, the membership of the Panel was increased from twelve to twenty-five members to provide expertise in pre-Columbian, Primitive, Far Eastern and Asian Art and prints.

2. Meetings are held separately but follow similar procedures.

G. 1984 Art Advisory Panel

Annual Report: Six meetings were held

1. Panel reviewed 1672 items with an aggregate taxpayer valuation of $120,000,000 in 258 taxpayer cases.

2. The claimed valued of the average charitable contribution item was $24,000. The average estate and gift item was $369,000.

3. The Panelists recommended adjustments of approximately $19,000,000.

This amounted to a total 58 percent net reduction from charitable contribution claims and a 49 percent increase on estate and gift appraisals.

4. In 1984,

a. Charitable Contributions -- $34 million total

22% accepted
73% adjusted

Average Over-valuation Item was:

Ptg. & Sculp.	301%
Far Eastern	927%
Primitive	1959%

Reduction of $11.7 million

In 1980 - 1982: Average over-valuation was 560%

In 1983: Average over-valuation was 671%

b. Estates - 66% of the items were accepted - $86 million total

Average undervaluation item 68% on each adjusted item.

Increase of $6 million

In 1980 - 1982: Average undervaluation was 96%
In 1983: Average undervaluation was 83%

2. Approximately three times the number of items, two times the total claimed value and 100 additional cases were reviewed in 1984 as compared with 1983 because of this Panel expansion.

V. Art Print Advisory Panel:

A. On November 13, 1980 the charter for the Art Print Advisory Panel of the Commissioner of Internal Revenue was authorized by the Assistant Secretary to deal with abusive tax shelters in the area of multiple art works.

B. It assisted the Internal Revenue Service by reviewing and evaluating the acceptability of appraisals and value allocations on art prints and related property submitted by taxpayers in support of fair market value claimed on works of art.

C. Since its establishment, the Print Panel has reviewed about 1650 items with a total taxpayer claimed value of $219,758,000. The Panelists recommended adjustments of $216,881,000. Due to a sharp decrease in the number of print referrals, the Art Print Panel was merged with the Art Advisory Panel in 1984.

D. The first three print tax shelter cases heard in U.S. Tax Court were recently decided. Using four members of the Panel as expert witnesses in these cases, the Service's positions were completely upheld.

Mario and Marie Reali
Stanley and Diane Feingold
(T. C. Memo 1984-427)

Dennis and Trese Harrington
(T. C. Memo 1984-428)

VI. Conclusion:

A. We follow the cases all the way through the system and provide assistance on each level.

Exam - Reconsideration
Appeals
Counsel

B. Participate in conferences and provide expert witnesses and testify as expert witnesses.

C. Few cases go to trial, however, when they do we try to get the best experts to testify for the Service.

D. We will assist on cases not previously reviewed by the National Office Art Valuation Group and analyze the taxpayer's appraiser's report and reasoning.

EXHIBITS

1. Revenue Procedure 66-49, 1966-2 C.B. 1257.

2. Publication 561 "Determining the Value of Donated Property". (Rev. Nov. 84)

3. "Deductions in Excess of $5,000 Claimed for Certain Charitable Contributions of Property and Information Returns by Donees who make Certain Dispositions of Donated Property," Federal Register, Vol. 49, No. 252, Monday, December 31, 1984, pp. 50657 - 50663.

4. Form 8283, Noncash Charitable Contributions Appraisal Summary (when available).

5. Form 8282, Donee Information Return (when available).

6. Annual Art Advisory Panel Summary Meeting Report for 1984.

PREPARED STATEMENTS OF WITNESSES

OPENING STATEMENT
JAMES I OWENS
ACTING COMMISSIONER OF INTERNAL REVENUE
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
HOUSE WAYS AND MEANS COMMITTEE
JUNE 3, 1986

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I AM PLEASED TO BE HERE TODAY TO DISCUSS THE TAX ADMINISTRATION ISSUES THAT ARISE IN THE VALUATION OF ARTWORK AND, IN PARTICULAR, THE ACTIVITIES OF THE SERVICE'S ART ADVISORY PANEL. WITH ME TODAY ARE FREDERIC P. WILLIAMS, ASSISTANT COMMISSIONER (EXAMINATION) AND KAREN CAROLAN, CHIEF, ART VALUATION SECTION IN THE APPEALS DIVISION. IN MY TESTIMONY TODAY I WILL DISCUSS THE PROBLEMS OF OVERVALUATION AND UNDERVALUATION OF ARTWORK, THE BACKGROUND OF THE ART ADVISORY PANEL, THE WORK OF THE IRS ART VALUATION SECTION, AND CURRENT LAW PENALTY PROVISIONS.

QUESTIONS OF APPROPRIATE VALUATION OF ARTWORK CAN HAVE A VARIETY OF TAX RAMIFICATIONS. FOR EXAMPLE, VALUATION IS ESSENTIAL IN DETERMINING THE APPROPRIATE DOLLAR AMOUNT OF CHARITABLE CONTRIBUTIONS FOR DONATIONS OF ARTWORK, THE DETERMINATION OF THE TAX BASE FOR ESTATE AND GIFT TAXES, AND THE DETERMINATION OF THE BENEFITS ASSOCIATED WITH PROPERTY ELIGIBLE FOR DEPRECIATION OR THE INVESTMENT TAX CREDIT. AS A RESULT, THE PROBLEM OF VALUATION CAN BE EITHER OVERVALUATION (FOR EXAMPLE, FOR CHARITABLE CONTRIBUTION PURPOSES) OR UNDERVALUATION (FOR EXAMPLE, FOR ESTATE OR GIFT TAX PURPOSES).

VALUATION ISSUES ARISE THROUGHOUT THE INTERNAL REVENUE CODE. BECAUSE VALUATION PROBLEMS ARE SO DEPENDENT UPON THE FACTS AND CIRCUMSTANCES OF EACH INDIVIDUAL CASE, THESE ISSUES ARE AMONG THE MOST DIFFICULT FACING THE TAX ADMINISTRATOR. IN ADDITION, THE NORMAL PROBLEMS ASSOCIATED WITH VALUATION OF PROPERTY ARE FURTHER COMPLICATED IN THE CONTEXT OF VALUING ART. AS THE COMMITTEE WILL SEE FROM A BRIEF SLIDE PRESENTATION THAT WILL ACCOMPANY MY TESTIMONY, THE COMPONENTS OF VALUE IN ARTWORK ARE FREQUENTLY MORE SUBTLE, VOLATILE, AND COMPLEX THAN THE COMPONENTS OF VALUE IN MORE CONVENTIONAL TAX CONTEXTS SUCH AS THE VALUATION OF AN OFFICE BUILDING OR DEPRECIABLE EQUIPMENT. CONSEQUENTLY, THE SERVICE IS DEPENDENT UPON ITS OWN ART EXPERTS AND THE ASSISTANCE OF OUTSIDE CONSULTANTS SUCH AS THOSE REPRESENTED ON THE ART ADVISORY PANEL.

THE HISTORY AND OPERATIONS OF THE ART ADVISORY PANEL

THE COMMISSIONER'S ART ADVISORY PANEL WAS ESTABLISHED IN 1968 TO ADDRESS PROBLEMS ARISING WITH RESPECT TO THE VALUATION OF ART. AT THAT TIME THERE WAS AN INCREASING RECOGNITION BY BOTH THE INTERNAL REVENUE SERVICE AND PROFESSIONALS IN THE ART WORLD THAT VALUATION ISSUES WERE BECOMING A GROWING AREA OF TAXPAYER NON-COMPLIANCE. A COOPERATIVE EFFORT INVOLVING THE IRS, THE ART DEALERS ASSOCIATION OF AMERICA AND MUSEUM OFFICIALS LED TO THE DEVELOPMENT OF A SYSTEM TO MONITOR APPRAISALS OF ART WORK THROUGH THE ESTABLISHMENT OF THE COMMISSIONER'S ART ADVISORY PANEL. THE PANEL ASSISTS THE INTERNAL REVENUE SERVICE BY REVIEWING AND EVALUATING THE ACCEPTABILITY OF PROPERTY APPRAISALS SUBMITTED BY TAXPAYERS IN SUPPORT OF THE FAIR MARKET VALUE CLAIMED ON WORKS OF ART INVOLVED IN FEDERAL INCOME, ESTATE OR GIFT TAXES.

CURRENTLY THE PANEL MAY INCLUDE UP TO 25 MEMBERS DRAWN FROM VARIOUS SEGMENTS OF THE ART WORLD. TO ENSURE REPRESENTATION OF BOTH SELLERS' AND BUYERS' PERSPECTIVES REGARDING ART TRENDS AND VALUES, THE PANEL COMPOSITION IS DIVERSE WITH EIGHT TO TEN ART DEALERS AND FIFTEEN TO SEVENTEEN MUSEUM DIRECTORS, CURATORS AND SCHOLARS. SPECIALISTS IN EACH OF THE MAJOR SCHOOLS AND PERIODS OF ART ARE SELECTED AND SPECIALISTS IN A PARTICULAR FIELD OF ART ARE SELECTED AS NEEDED. PANELISTS ARE SUBJECT TO REVIEW AND REAPPOINTMENT ANNUALLY. ALL PANELISTS ARE PROCESSED AS SPECIAL GOVERNMENT EMPLOYEES AND MUST SUBMIT THE REQUIRED FINANCIAL DISCLOSURE STATEMENTS FOR REVIEW AND APPROVAL BY THE ETHICS COMMITTEE OF THE DEPARTMENT OF TREASURY. PANEL MEMBERS ARE BOUND BY THE LAWS PROHIBITING DISCLOSURE OF INFORMATION FROM TAX RETURNS. PANELISTS SERVE WITHOUT PAY; HOWEVER, REIMBURSEMENT FOR TRAVEL AND LODGING EXPENSES IN CONNECTION WITH PANEL MEETINGS IS PROVIDED.

WHEN ORIGINALLY FORMED THE ART ADVISORY PANEL FOCUSED PRIMARILY ON PAINTING AND SCULPTURE. IN 1984 THE PANEL WAS EXPANDED TO ADD EXPERTISE IN (1) PRE-COLUMBIAN AND PRIMITIVE ART AND (2) FAR EASTERN AND ASIAN ART. THESE TWO NEW GROUPS WERE ADDED BECAUSE THE SERVICE FOUND THAT OVERVALUATION OF THESE TYPES OF ART WAS BECOMING MORE COMMON AND SPECIAL EXPERTISE WAS NEEDED IN THESE AREAS. CURRENTLY, THE PANEL MEMBERSHIP IS DIVIDED AMONG A PAINTING AND SCULPTURE GROUP AND THESE TWO POST-1984 GROUPS. THE MOST RECENT PANEL MEETING WAS HELD ON MAY 22 TO REVIEW FAR EASTERN AND ASIAN ART.

A WORK OF ART MAY COME BEFORE THE PANEL IN SEVERAL WAYS. UNDER THE PANEL'S ORIGINAL RULES, ANY AUDITED RETURN CONTAINING AN APPRAISAL OF A SINGLE WORK OF ART WITH A CLAIMED VALUE OF $20,000 OR MORE WAS REFERRED TO THE NATIONAL OFFICE FOR REVIEW. THIS REFERRAL AUTHORITY HAS BEEN EXPANDED TO COVER AUDITED RETURNS CONTAINING AN APPRAISAL OF ANY COLLECTION OF ARTWORK VALUED AT $20,000 OR MORE. IN ADDITION, IRS FIELD EXAMINERS ARE ENCOURAGED TO REQUEST VALUATION ASSISTANCE ON WORKS OF ART AT ANY TIME.

PANELISTS ARE PROVIDED WITH PHOTOGRAPHS AND OTHER MATERIALS REGARDING THE ARTWORK TO BE REVIEWED IN ADVANCE OF MEETINGS. PANELISTS FREQUENTLY CONDUCT THEIR OWN RESEARCH AS WELL. AT THE MEETING, PANEL MEMBERS EXPRESS THEIR OPINIONS AS TO THE ACCEPTABILITY OF THE CLAIMED VALUATION. AS A GENERAL RULE, THE PANEL MEMBERS ARE ABLE TO REACH A CONCENSUS ON VALUE VERY QUICKLY. IN THE RELATIVELY RARE INSTANCES IN WHICH A CONSENSUS IS NOT REACHED, THE PANELISTS WILL OBTAIN ADDITIONAL INFORMATION EITHER PERSONALLY OR THROUGH THE EFFORTS OF THE IRS STAFF.

DURING THE YEARS 1977 THROUGH 1985 THE ART ADVISORY PANEL REVIEWED 1565 TAXPAYER CASES INVOLVING 6717 ITEMS OF ART. THE PANEL RECOMMENDED AN ADJUSTMENT OF VALUATION FOR APPROXIMATELY HALF OF THE ITEMS REVIEWED. THE TOTAL CLAIMED VALUE OF THESE ITEMS WAS $525,000,000 AND THE PANEL RECOMMENDED ADJUSTMENTS OF $115,000,000.

SINCE THE EXPANSION OF THE PANEL IN 1984 TO INCLUDE EXPERTISE IN PRIMITIVE/PRE-COLUMBIAN AND FAR EASTERN/ASIAN ART AND THE EXPANSION OF THE SCREENING CRITERIA TO INCLUDE COLLECTIONS OF ART VALUED AT $20,000 OR MORE, THE PANEL IS REVIEWING AN INCREASING NUMBER OF ITEMS. PERHAPS AS A RESULT OF THE INCREASED REVIEW OF LOWER VALUED ITEMS DURING 1984 AND 1985, THE PERCENT OF ITEMS FOR WHICH THE PANEL RECOMMENDS A CHANGE IN VALUE IS RISING. FOR EXAMPLE, SINCE 1984 ADJUSTMENTS WERE RECOMMENDED ON 73.5% OF ITEMS REVIEWED. AN ADDITIONAL 5.5% REQUIRED FURTHER DEVELOPMENT FOR DETERMINATION OF VALUE.

THE ART PRINT ADVISORY PANEL

ALTHOUGH THE ART PANEL WAS INITIATED IN 1968 AND WAS PRINCIPALLY INVOLVED IN REVIEWING VALUATIONS OF ORIGINAL WORKS OF PAINTING AND SCULPTURE, MUCH OF THE PANEL'S NOTORIETY CAME FROM ITS REVIEWS OF ART PRINTS. DURING THE LATE 1970S AND EARLY 1980S, CERTAIN TAX SHELTER SCHEMES UTILIZING ART PRINTS BECAME VERY POPULAR. THE KEY TO THESE SCHEMES WAS THE GROSS OVERVALUATION OF PROPERTY FOLLOWED BY THE USE OF INVESTMENT TAX CREDIT AND DEPRECIATION BY THE TAXPAYER.

IN RESPONSE TO THESE ABUSIVE SCHEMES, THE ART PRINT ADVISORY PANEL WAS FORMED. FROM ITS ESTABLISHMENT IN NOVEMBER OF 1980 THROUGH 1983, THE ART PRINT PANEL REVIEWED 1650 ITEMS. TOTAL TAXPAYER-CLAIMED VALUE FOR THESE ITEMS WAS $219,758,000.00 AND THE PANEL RECOMMENDED ADJUSTMENTS TOTALING $216,881,000.00 -- A 98.6% REDUCTION FROM THE CLAIMED VALUE. EIGHT OF THE ART PRINT TAX SHELTER CASES WERE LITIGATED, AND AN ART PRINT ADVISORY PANELIST TESTIFIED AS AN EXPERT WITNESS IN SEVEN OF THESE CASES. THE SERVICE PREVAILED IN SIX CASES, AND TWO CASES ARE STILL AWAITING DECISION.

THE ART PRINT ADVISORY PANEL WAS A SUCCESSFUL EFFORT WHICH HAS CONTRIBUTED TO THE VIRTUAL ELIMINATION OF THE ABUSIVE ART PRINT TAX SHELTER SCHEMES IT WAS ESTABLISHED TO COMBAT. DUE TO A LACK OF CASES, THE CHARTER FOR THE ART PRINT ADVISORY PANEL WAS ALLOWED TO EXPIRE IN MARCH OF 1985.

THE IRS ART VALUATION SECTION

IN ADDITION TO THE PANEL, THE NATIONAL OFFICE HAS AN ART VALUATION SECTION WHICH IS AVAILABLE TO PROVIDE ASSISTANCE TO FIELD EXAMINERS AND THE APPEALS DIVISION, AS WELL AS TO PROVIDE SUPPORT SERVICES FOR THE ART ADVISORY PANEL. THE SERVICE'S ART VALUATION STAFF IS COMPOSED OF FIVE FULL TIME APPRAISERS WITH BACKGROUNDS IN ART HISTORY. THEY COORDINATE PANEL ACTIVITIES, RESEARCH AND PREPARE MATERIALS FOR PANELISTS TO REVIEW IN CONNECTION WITH VALUATIONS AND ALSO REVIEW APPRAISALS OF ART WORKS WHICH ARE NOT REFERRED TO THE PANEL.

AFTER PANEL MEETINGS, THE NATIONAL OFFICE ART APPRAISERS PREPARE VALUATION REPORTS ON THE REJECTED APPRAISALS. THESE REPORTS ARE RETURNED TO THE DISTRICT OFFICE WHICH INITIATED THE REFERRAL TO THE PANEL. THE TAXPAYER IS NOTIFIED OF THE PANEL DECISION AND PROVIDED WITH A COPY OF THE REPORT AND A LIST OF THE PANELISTS.

AT THIS POINT IN MY STATEMENT I WOULD LIKE TO INTRODUCE KAREN CAROLAN, CHIEF, VALUATION SECTION. MS. CAROLAN IS AN EXPERT IN ART VALUATION ISSUES AND IS THE SENIOR IRS OFFICIAL WITH OPERATIONAL RESPONSIBILITY FOR THE ART ADVISORY PANEL. IDEALLY, HER PRESENTATION MIGHT SHOW ACTUAL WORKS OF ART THAT CAME BEFORE THE PANEL ALONG WITH THE TAXPAYER AND SERVICE VALUATIONS. HOWEVER, THE CONFIDENTIALITY PROVISIONS OF SECTION 6103 OF THE CODE PROHIBIT THE USE OF LIVE EXAMPLES. INSTEAD MS. CAROLAN WILL USE THIS OPPORTUNITY TO PROVIDE THE SUBCOMMITTEE WITH EXAMPLES OF THE KINDS OF ISSUES THAT COME BEFORE THE PANEL. THESE EXAMPLES ARE EITHER FROM PUBLIC SALE INFORMATION OR RELATE TO CASES THAT ARE PUBLIC INFORMATION.

(SLIDE PRESENTATION)

NOW THAT THE SUBCOMMITTEE HAS THIS ADDITIONAL BACKGROUND ON THE PROBLEMS ASSOCIATED WITH VALUATION OF PROPERTY, I WOULD LIKE TO TURN TO SOME STATISTICS ON THE AREA OF GREATEST DIFFICULTY FOR THE SERVICE, THE AREA OF CHARITABLE CONTRIBUTIONS.

CHARITABLE CONTRIBUTION STATISTICS

CONSISTENT WITH THE RULES OF SECTION 170 OF THE CODE, CHARITABLE CONTRIBUTIONS ARE ALLOWED AS A DEDUCTION ON FEDERAL INCOME TAX RETURNS. IN TAX YEAR 1983, 32.0 MILLION TAXPAYERS CLAIMED TOTAL CHARITABLE CONTRIBUTIONS OF $37.7 BILLION; 7.8 MILLION OF THESE TAXPAYERS MADE NON-CASH CONTRIBUTIONS OF $5.8 BILLION. FOR 1983, THE TOTAL REDUCTION IN TAX LIABILITY RESULTING FROM CHARITABLE CONTRIBUTIONS IS ESTIMATED TO BE APPROXIMATELY $13 BILLION. THE IRS DOES NOT MAINTAIN STATISTICS THAT WOULD PERMIT AN ANALYSIS OF THE AMOUNT OF THESE NON-CASH CHARITABLE DEDUCTIONS ATTRIBUTABLE TO CONTRIBUTIONS OF ART.

AS THIS COMMITTEE KNOWS, EVERY THREE YEARS THE IRS COMPLETES ITS COMPREHENSIVE STUDY OF FILED INDIVIDUAL INCOME TAX RETURNS. THIS STUDY IS KNOWN AS TCMP, OR THE TAXPAYER COMPLIANCE MEASUREMENT PROGRAM. THE MOST RECENT TCMP DATA PROVIDES VALUABLE INSIGHT INTO THE QUESTION OF TAXPAYER COMPLIANCE LEVELS IN THE CHARITABLE CONTRIBUTION AREA. IN PARTICULAR, THE TCMP STUDY SHOWED THAT ABOUT 20% OF TAXPAYERS OVERSTATED THEIR CHARITABLE CONTRIBUTIONS AND 7% UNDERSTATED THEM. COMPLIANCE WITH RESPECT TO CONTRIBUTIONS OF PROPERTY WAS MEASURABLY LOWER THAN CONTRIBUTIONS OF CASH. IN THE AREA OF NON-CASH CONTRIBUTIONS, EVEN THOUGH 1/3 FEWER TAXPAYERS MADE ERRORS, THE SIZE OF THEIR ERRORS WAS ABOUT 1/3 GREATER.

QUALIFIED APPRAISAL REQUIREMENT

FOR CHARITABLE CONTRIBUTIONS MADE AFTER DECEMBER 31, 1984, THE SERVICE WILL NOW HAVE AVAILABLE FOR REVIEW "QUALIFIED APPRAISALS" SUBMITTED WITH THE TAX RETURN ON WHICH A DEDUCTION FOR DONATED ART WORK WAS CLAIMED. THE TAX REFORM ACT OF 1984 DIRECTED THE SERVICE TO PRESCRIBE REGULATIONS REQUIRING INDIVIDUALS AND CERTAIN OTHER TAXPAYERS TO OBTAIN QUALIFIED APPRAISALS FOR CONTRIBUTIONS OF ARTWORK AND OTHER PROPERTY WHOSE CLAIMED VALUE EXCEEDS $5,000.00.

IN ADDITION TO THESE REGULATIONS, THE SERVICE ISSUED FORM 8283 WHICH A TAXPAYER MUST FILE WHEN CLAIMING THE DEDUCTION. FORM 8283 REQUIRES A DESCRIPTION OF THE DONATED PROPERTY, A LISTING OF ITS FAIR MARKET VALUE AND COST TO THE DONOR, AN ACKNOWLEDGEMENT OF RECEIPT OF THE PROPERTY BY THE DONEE, AND A CERTIFICATION BY THE APPRAISER THAT HE OR SHE IS A QUALIFIED APPRAISER. A "QUALIFIED APPRAISER" MUST BE QUALIFIED TO MAKE APPRAISALS OF THE TYPE OF PROPERTY DONATED. FURTHER, THE APPRAISER CANNOT BE THE TAXPAYER, THE RECIPIENT, A PARTY TO THE TRANSACTION IN WHICH THE TAXPAYER ACQUIRED THE PROPERTY OR ANY PERSON WHOSE RELATIONSHIP TO THE TAXPAYER WOULD CAUSE A REASONABLE PERSON TO QUESTION THE APPRAISER'S INDEPENDENCE.

THE APPRAISAL ITSELF MUST BE MADE WITHIN 60 DAYS PRIOR TO THE DATE OF CONTRIBUTION AND MUST INCLUDE THE SPECIFIC BASIS OF THE VALUATION, A STATEMENT THAT THE APPRAISAL WAS PREPARED FOR INCOME TAX PURPOSES, THE APPRAISER'S QUALIFICATIONS AND THE SIGNATURE AND TAXPAYER IDENTIFICATION NUMBER OF THE APPRAISER.

FORM 8283 ALSO REQUIRES THAT THE RECIPIENT ACKNOWLEDGE THAT IT IS AN ORGANIZATION QUALIFIED TO RECEIVE CHARITABLE CONTRIBUTIONS UNDER IRC SECTION 170(C) AND AFFIRM THAT IN THE EVENT IT SELLS, EXCHANGES OR OTHERWISE DISPOSES OF THE PROPERTY WITHIN TWO YEARS, IT WILL FILE AN INFORMATION RETURN WITH THE IRS ON FORM 8282. THIS INFORMATION RETURN MUST DESCRIBE THE DONATED PROPERTY AND PROVIDE THE DATE OF CONTRIBUTION, THE DATE OF SALE, EXCHANGE OR TRADE OF THE DONATED PROPERTY AND THE AMOUNT RECEIVED FOR THE PROPERTY. THE SERVICE BELIEVES THAT THESE NEW REQUIREMENTS WILL BE EXTREMELY HELPFUL IN REVIEWING CLAIMED VALUATIONS OF DONATED ARTWORK. COPIES OF THE FORMS ARE ATTACHED TO MY STATEMENT.

APPLICABLE PENALTY PROVISIONS

WITH RESPECT TO ART VALUATION PROBLEMS, A WIDE RANGE OF IRC PENALTY PROVISIONS MAY APPLY. SOME OF THE PROVISIONS ARE SPECIFIC TO THE PROBLEMS OF OVERVALUATION OR UNDERVALUATION, BUT OTHERS ARE GENERIC IN NATURE. WITHOUT INTENDING TO PROVIDE AN EXHAUSTIVE OVERVIEW OF THE POTENTIAL PENALTY PROVISIONS, IT WOULD BE APPROPRIATE TO HIGHLIGHT SOME RECENT CHANGES THAT HAVE GENERAL APPLICATION TO ART VALUATION PROBLEMS.

SECTION 6659 -- ADDITION TO TAX FOR VALUATION OVERSTATEMENTS

THE SECTION 6659 PENALTY PROVIDES FOR AN ADDITION TO TAX FOR CERTAIN UNDERPAYMENTS ATTRIBUTABLE TO A VALUATION OVERSTATMENT. THE PENALTY IS GENERALLY BASED ON A SLIDING SCALE, BECOMING MORE SEVERE WITH THE SEVERITY OF THE OVERVALUATION. SECTION 6659(F) PROVIDES SPECIAL AND GENERALLY MORE STRINGENT RULES FOR CHARITABLE CONTRIBUTIONS. IF A TAXPAYER'S CLAIMED VALUE OF A CHARITABLE CONTRIBUTION IS 150% OR MORE OF THE CORRECT AMOUNT, AN ADDITION TO TAX OF 30% OF THE UNDERPAYMENT MAY APPLY. THIS PENALTY MAY BE WAIVED IF THE TAXPAYER'S VALUE WAS BASED ON A QUALIFIED APPRAISAL BY A QUALIFIED APPRAISER AND THE TAXPAYER MADE A GOOD FAITH INVESTIGATION INTO THE VALUE OF THE PROPERTY. THIS PENALTY WAS ADDED IN 1981 AND THE SPECIAL CHARITABLE CONTRIBUTION RULES WERE ADDED TO SECTION 6659 IN 1984.

SECTION 6660 -- ADDITION TO TAX FOR VALUATION UNDERSTATEMENTS

A SLIDING SCALE PENALTY SIMILAR TO THAT FOUND IN THE VALUATION OVERSTATEMENT AREA IS ALSO PRESENT FOR VALUATION UNDERSTATEMENTS. THIS PENALTY IS APPLICABLE FOR PURPOSES OF ESTATE AND GIFT TAX LIABILITIES. THIS PENALTY WAS ENACTED IN 1984.

SECTION 6700 AND 6701 -- TAX SHELTER PENALTIES

DURING THE 1970'S AND EARLY 1980'S CHARITABLE CONTRIBUTIONS OF ARTWORK AND IN PARTICULAR ART PRINT SCHEMES WERE USED AS TAX SHELTER MECHANISMS. SECTION 6700, THE PENALTY FOR PROMOTING ABUSIVE TAX SHELTERS, AND SECTION 6701, THE PENALTY FOR AIDING AND ABETTING THE UNDERSTATEMENTS OF TAX, WERE USED TO COMBAT THIS ABUSIVE SHELTER ACTIVITY. THESE PENALTIES WERE ENACTED IN 1982.

REGULATION OF APPRAISERS -- 31 USC 330

ANOTHER CHANGE MADE IN THE 1984 ACT WAS THE AMENDMENT OF TITLE 31 USC SECTION 330 TO GIVE THE SECRETARY OF THE TREASURY THE AUTHORITY TO BAR FROM APPEARING BEFORE THE IRS ANY APPRAISER AGAINST WHOM A SECTION 6701 (AIDING AND ABETTING PENALTY) HAS BEEN ASSESSED.

AS I MENTIONED, THESE PENALTIES ARE NOT EXCLUSIVE. THE FRAUD OR NEGLIGENCE PENALTY UNDER SECTION 6653 MAY APPLY OR THE SUBSTANTIAL UNDERSTATEMENT PENALTY UNDER SECTION 6661 MAY BE APPLICABLE.

SINCE THE IRS GENERALLY EXAMINES RETURNS A YEAR OR TWO AFTER THEY ARE FILED, WE HAVE ONLY A FEW YEARS EXPERIENCE WITH THE 1981 AND 1982 PENALTY CHANGES AND VIRTUALLY NO EXPERIENCE WITH THE 1984 CHANGES. CONSEQUENTLY, THE SERVICE CURRENTLY HAS NO LEGISLATIVE RECOMMENDATIONS WITH RESPECT TO STATUTORY CHANGES.

THE EXPANDED SCOPE OF THE ART ADVISORY PANEL, COMBINED WITH THE ARRAY OF PENALTY PROVISIONS AND THE NEW QUALIFIED APPRAISAL AND DONEE INFORMATION FORMS NOW PROVIDE US WITH VALUABLE TOOLS TO MONITOR COMPLIANCE AND COMBAT ABUSE IN THIS AREA. WE RECOGNIZE THE NEED FOR CONTINUED VIGILANCE AND WE WILL CONTINUE TO USE THE TOOLS WHICH CONGRESS HAS MADE AVAILABLE TO US IN CONJUNCTION WITH THE ART ADVISORY PANEL IN ORDER TO FULFILL OUR MISSION.

MY COLLEAGUES AND I ARE AVAILABLE TO ANSWER ANY QUESTIONS YOU OR THE MEMBERS MAY HAVE.

Form **8283** (Rev. October 1985)

Department of the Treasury
Internal Revenue Service

Noncash Charitable Contributions

▶ Attach to Your Federal Income Tax Return

OMB No. 1545-0908
Expires 9-30-88
55

Name(s) as shown on your income tax return | Identification number

Section A.—Contribution of property if the total claimed value of all property contributed exceeds $500. *(If the value of one item or group of similar items, other than publicly traded securities, exceeds $5,000, complete only Section B for that property.)*

Part I **Information on Donated Property**

1	(a) Name and address of the donee organization	(b) Description of donated property (attach a separate sheet if more space is needed)
A		
B		
C		
D		
E		

	(c) Date of the contribution	(d) Date acquired by donor (mo., yr.)	(e) How acquired by donor	(f) Donor's cost or adjusted basis	(g) Fair market value	(h) Method used to determine the fair market value
A						
B						
C						
D						
E						

Part II **Other Information**—Complete questions 2 and 3 only if you gave less than the entire interest in property or if restrictions were attached to the contribution.

2 If less than the entire interest in the property is contributed during the year, complete the following.

(a) Total amount claimed as a deduction for the property listed in Part I for this tax year _____; for any prior tax year(s) _____

(b) Name and address of each organization to which any such contribution was made in a prior year (complete only if different from the donee organization above).

_____
Charitable organization (Donee) name

_____
Number and street

_____
City or town, state, and ZIP code

(c) The place where any tangible property is located or kept. _____

(d) Name of any person, other than the donee organization, having actual possession of the property. _____

3 If conditions were attached to the contribution, answer the following questions.	Yes	No
(a) Is there a restriction either temporarily or permanently on the donee's right to use or dispose of the donated property?		
(b) Did you give to anyone (other than the donee organization or another organization participating with the donee organization in cooperative fundraising) the right to the income from the donated property or to the possession of the property, including the right to vote donated securities, to acquire the property by purchase or otherwise, or to designate the person having such income, possession, or right to acquire?		
(c) Is there a restriction limiting the donated property for a particular use?		

Form 8283 (Rev. 10-85) Page 2

Name(s) as shown on your income tax return (Do not enter name and identification number if shown on the other side.) | Identification Number

Section B.—Appraisal Summary—Contribution of property if the claimed value of one item or group of similar items exceeds $5,000 *(Report contributions of publicly traded securities only in Section A.)*

Part I Donee Acknowledgement *(To be completed by the charitable organization)*

1 This charitable organization acknowledges that it is a qualified organization under section 170(c) and that it received the donated property as described in Part II on _____ (Date)

Furthermore, this organization affirms that in the event it sells, exchanges, or otherwise disposes of the property (or any portion thereof) within two years after the date of receipt, it will file an information return (**Form 8282**, Donee Information Return) with the IRS and furnish the donor a copy of that return. This acknowledgement does not represent concurrence in the claimed fair market value.

Charitable organization (Donee) name | Employer identification number

Number and street

City or town, state, and ZIP code

Authorized signature | Title | Date

Part II Information on Donated Property *(To be completed by the taxpayer and/or appraiser)*

2 (a) Description of donated property (attach a separate sheet if more space is needed)	(b) Date acquired by donor (mo., yr.)	(c) How acquired by donor	(d) Donor's cost or adjusted basis	(e) Appraised fair market value

3 If tangible property was donated, a brief summary of the overall physical condition of the property at the time of the gift.

Part III Certification of Appraiser *(To be completed by the appraiser of the above donated property)*

I declare that I am not the donor, the donee, a party to the transaction in which the donor acquired the property, employed by or related to any of the foregoing persons, or a person whose relationship to any of the foregoing persons would cause a reasonable person to question my independence as an appraiser.

Also, I declare that I hold myself out to the public as an appraiser and that because of my qualifications as described in the appraisal, I am qualified to make appraisals of the type of property being valued. I certify the appraisal fees were not based upon a percentage of the appraised property value. Furthermore, I understand that a false or fraudulent overstatement of the property value as described in the qualified appraisal or this appraisal summary may subject me to the civil penalty under section 6701(a) (aiding and abetting the understatement of tax liability). I affirm that I have not been barred from presenting evidence or testimony by the Director of Practice.

Please Sign Here Signature ▶ Title ▶ Date ▶

Business address | Identification number

City or town, state, and ZIP code

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- 8282
(Rev. 1985) *
partment of the Treasury
al Revenue Service

Donee Information Return

(Sale, Exchange, or Trade of Donated Property)

Expires 12-31-87

Give Copy to Donor

Charitable organization (donee) name | Employer identification number

Number and street

Please or Type

City or town, state, and ZIP code

Name of donor(s) who contributed the gift | Donor identification number

Donor address (Number and street)

City, town or post office, state and ZIP code

(a) Description of donated property sold, exchanged, or traded (Attach a separate sheet if more space is needed)	(b) Date item(s) contributed	(c) Date item(s) sold, exchanged, or traded	(d) Amount received

Instructions

Paperwork Reduction Act Notice.—We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

New Law.—The Tax Reform Act of 1984 (P.L. 98-369) requires the donee of any charitable deduction property who sells, exchanges, or otherwise disposes of the property within two years after the date of receipt of the property to file the information shown on this return with the Internal Revenue Service.

Charitable Deduction Property.—The term "charitable deduction property" means any property (other than money or publicly traded securities) contributed after December 31, 1984, with respect to which the donee signed Form 8283, Noncash Charitable Contributions Appraisal Summary.

When to File.—Form 8282 must be filed with the IRS within 90 days after the donee disposes of the property. Also, the donee must send a copy of this form to the donor.

Where to File.—File this form with the Internal Revenue Service Center in Cincinnati, OH 45944.

Penalties.—Failure to file this information return and failure to furnish a copy of this return to the donor will make the charitable organization liable for a $50 penalty for each failure. See sections 6652, 6676, and 6678 of the Internal Revenue Code.

STATEMENT OF JAMES D. BURKE, DIRECTOR, THE SAINT LOUIS ART MUSEUM

My name is James D. Burke, and I am the Director and Chief Executive Officer of The Saint Louis Art Museum. I am pleased to appear here to discuss the art appraisal and evaluation process of the IRS.

I was an active panelist of the IRS Print Panel from 1981 to 1983, which dealt almost entirely with tax sheltered publishing of multiple editions of lithographs, silkscreens, and other prints. During the four year life of this specially-convened panel, thousands of cases were reviewed and settled. The recommended adjustments were huge, running to $219,758,000, according to IRS statistics. The IRS staff can give you a better, more accurate report on this, and it is not my intent to review all the facts and figures here today. My point is simple here--that panel saved millions in claimed tax savings, for it seemed to me that 95% or more of the cases we reviewed were wildly overvalued by the taxpayer involved. This resulted in a huge gain for the Treasury, and threw out silly claims that were neither supported by good economic sense nor by any social or artistic utility, at least in my opinion.

Since 1985, I have been a member of the Commissioners Art Advisory Panel at IRS. Like the Print Panel, it is an area of public policy where I feel I can have a useful effect.

Like many colleagues in the large museums with comprehensive collections, I have closely followed the national and international art market in a number of specific areas for over twenty years. With our six curators and their assistants, I follow the market closely and shop widely to make our choices for acquisitions. Since we don't have a direct commercial stake in the market, we represent a free-ranging buyer's attitude.

The Art Advisory Panel is a good, honest arbitration board, acting between the claimants, the IRS staff and the tax court. Over the years of its existence, it has developed an excellent reputation for diligence and avoidance of conflicts of interest. The presence and actions of this panel of experts has surely avoided much litigation between taxpayers and the IRS, just because its members are so often well-known experts in the art market, being drawn from the ranks of auctioneers, art dealers and museums.

By the way of a rough guess, I would estimate that about 25% of the evaluations that we review are accepted without question, about 50% are off the mark by a small measure (over-or-undervalued by a third or so), and the remaining 25% are so outrageously under-or-overvalued as to be extreme. Of course, the last is the case where the big tax abuses lie. Since we review both estates, which tend to be understated, and charitable contributions, which tend toward overstatement, it is worth mentioning that the IRS staff show us only the work of art and the claim of value, so that our neutrality will not be compromised on such issues.

At this point, I feel that the evaluation and review process at IRS is working smoothly, has a diligent and excellent staff and a good productivity. I do feel that the committee should assure that they have a good photography budget, for the judgments made by the panel depend on it. The presence of this panel has had a healthy cautionary effect on over-valuation problems in the past, and I believe that its effectiveness is strong. I urge the committee's continuing support of this valuable process, for there is no doubt in my mind that the over-valuation abuses are greatly diminished from what they were ten or fifteen years ago.

STATEMENT OF ROBERT HATFIELD ELLSWORTH, R.H. ELLSWORTH, INC.

Ladies and gentlemen of the House, I am pleased to be here. Let me introduce myself. My name is Robert Hatfield Ellsworth. I have been a dealer in the Oriental Art field for over thirty-five years and have sold important works of art to almost every major museum in the United States. These include The Metropolitan Museum, The Freer Gallery, The Cleveland Museum of Art, William Rockhill Nelson Gallery of Art, among others. My reputation in the field of Oriental Fine Arts firmly rests on the foundation of the quality of the works sold to these institutions. I have written what is thought to be as the definitive work on Chinese furniture. I am also considered by many of my colleagues to be a collector. Over the years, I also have been involved in appraising. In 1979, I was asked to do the appraisal for death duties of the John D. Rockefeller 3rd Oriental Art collection. This collection included three hundred pieces and the appraisal totaled $20,878,800. This valuation was passed on by the Internal Revenue Service without a single adjustment. This appraisal more than likely contributed to the IRS Art Valuation Section's opinion that I would be qualified to sit on the Art Advisory Panel. The members of Art Valuation Section of the IRS choose all of the members of the Panel, and in answer to one of the questions posed by the Committee, I feel firmly that the IRS Valuation Section knows best who is qualified to sit on their panels, and that the selection of panel members should continue to remain within their jurisdiction.

As to a possible conflict of interest while on the Panel--and it has happened to all members of the Panel at one time or another--the individual concerned leaves the room.

As a dealer and appraiser for many years, I have been conscious that non-cash charitable contributions were in jeopardy due to the misuse by donors seeking tax shelters and appraisers who provided them with outrageously inflated appraisals. This law was being abused to the extent that in areas such as graphics, the works of art were being produced and marketed solely as a shelter. For many years prior to my becoming a member of the Art Advisory Panel, I freely supplied information to the Art Valuation Section of the IRS when it was requested. When I was asked to join the Panel, I felt it was my civic duty and beneficial to the entire field. I also believed the combined knowledge of a dealer, collector, and appraiser would be of considerable value to the Panel, and in the long run help prevent the loss of this essential law.

In this rather esoteric field, the members of the Far Eastern Art Appraisal Panel have been chosen for their extensive experience and knowledge, which can be drawn upon at any moment. With a panel of five, questions are often settled in minutes without wasted hours of research time. As we resolve the questions of authenticity, quality and valuation, the permanent members of the Valuation Section are therefore enabled to expand the range of their inquiry as well as the number of returns they can review.

For greater efficacy, there must be an increase in the number of reviewed tax returns that include art gifts. The Far Eastern Section is working very effectively. Once the Panel has got over the enormous backlog of material, a greater percentage of current returns could be reviewed. The Panel has now covered 1961 to 1973, but we still have ten years of backlog to eliminate. At the moment the panel is seeing a slight increase in overvaluations, due perhaps to the backlogged material which preceded the effectiveness of the the panel. In 1985, 84% of the items were judged by the panel to be overvalued. The panel reduced the valuations by 73%. The taxpayer is the beneficiary of these reductions.

The attitude expressed continuously since the first year of the Panel by people concerned is that appraisals we will see in the next few years will be increasingly conservative. The full effectiveness of our relatively young panel cannot be fairly judged until this backlog has been eliminated. We have already been able to pinpoint certain appraisers who consistently overvalue as well as certain museums that tend to be recipients of overvalued objects. In addition to this progress, we have closed at least one, if not two, tax shelter schemes in the Oriental art area.

Although museum curators and directors cannot legally be held accountable for the valuation of charitable contribution, we know, for example, of a conservative revalutation of a proposed gift recently recommended by the curator of paintings in one of America's most prestigious institutions. The curator's knowledge of the valuation of the gift prior to acceptance, thanks to 8283 made it possible for the curator to request a one-third reduction in the appraised value of the painting, prior to its acceptance. This was accomplished with no ill effects on the donor-museum relationship, secured the devaluation of an appraisal by a third. Such instances will multiply.

Now that The IRS has a panel of experts in the Far Eastern area to back up its decisions, it is able to go to court with a feeling of confidence. Our Panel has already had one instance where the taxpayer was ready to litigate the Valuation Section's decisions. However, just prior to going to court, the donor realized how formidable the Panel was, and backed down. Not only was there no litigation, there was no compromise settlement. The taxpayer accepted the Section's decision, paid all of the fines and went away. Another instance arose with a museum that has had rather a long go-round with our Panel and threatened up to fifty-eight separate lawsuits. The museum has finally stated they will accept the Panel's decision on a group of gifts valued well in excess of $1 million and is prepared to accept our approximate 70% reduction without the threatened litigation. Two further illustrations of our charm and growing effectiveness may be of interest; both concern donations of groups of what were called jade but were in large part softer stones of much less value. One group was appraised at $158,000 and the Panel's valuation was $65,500. The other group was appraised at $621,900 and the Panel's valuation was $88,630. Both devaluations were uncontested. The reduction of the appraised value of these cases was 86%.

The question I have been asked most often is "Can anything else be done to further curtail overvaluation?" My answer is yes, absolutely.

You ladies and gentlemen of Congress were farsighted when you added provisions to the Charitable Contribution requiring the appraiser to be legally responsible for his valuation. You called for a form showing the appraised value to be signed by the curator or the director of the institution accepting the gift [Form 8283]. These provisions have functioned as a tremendous check on abuse in the area of Fine Arts Charitable Contribution. However, I implore you to give the IRS Valuation Section and their panels more muscle. My suggestion is that a copy of Form 8283 be signed by both the curator and director of the institution accepting the gift, and be sent by the institution that has accepted the gift to the Valuation Department of the IRS. This simple forwarding of a copy of an existing form will enable the Valuation Section for the first time to have statistics on how many institutions accept art. It will help to uncover untold numbers of tax-exempt institutions whose returns have never been audited and who may be abusing the charitable contributions. This could save millions for the taxpayer and cost the Government very little to enforce. At this moment less than 2% of the tax returns in the U.S. can be reviewed. When the Fine Arts Valuation Department has access to a copy of all filed 8283 Forms, they will for the first time know who is giving, who is receiving, and what. With these statistics in hand, we will know how many people are involved in the process. The forms, once computerized, will allow the Art Valuation Section of the IRS to see a description, albeit brief, of the gift given, its valuation, who appraised it and who received it. Those with knowledge of specialized fields are like a farmer scanning ads for a pick-up truck. If a second-hand Ford in fair condition with 80,000 miles on it is advertised for between $1500 and $3000, the difference in asking price should relate to its condition. If the advertiser were asking $24,000 for it, you could assume there had been a typographical error. In the Chinese art world, if an 8283 describes a 19th century twelve inch blue-and white porcelain vase, the range could be a few hundred dollars to perhaps as high as ten to twelve thousand dollars. If the appraised value is thirty-five thousand dollars, the return should be reviewed. If the description is a 17th century blueand white vase, the range could be from three thousand dollars to fifty thousand dollars. If the blue and white vase were described as 14th or 15th century--the value could range from fifty thousand to two-hundred fifty thousand dollars. If the valuation is at the high-end of this range, the Service will have at their fingertips the name of the institution that has accepted the gift. If the institution is known to have collections in this area and of this quality, and the appraiser is qualified, most likely the valuation will stand up. If not, it should be reviewed by the Panel. Second-hand car dealers have manuals giving the range of values for each model and year. Art appraisers do not have such manuals, only personal knowledge, eye and experience. They must be allowed a margin of at least 20% in either direction, but not 200%. This data bank of 8283 forms in the hands of the Evaluation Section would also make it possible for the IRS to treat all donors equally.

Another improvement that could be made in the Panel is to make it possible for panel members with a wide range of experience and knowledge, to remain on panel for more than two one-year terms. Panelists such as Dr. Sherman E. Lee, whose

knowledge makes him a desireable addition to both the Paintings and Sculpture and Far East, should be allowed to remain for more than two one-year terms if willing. We are not paid and therefore should not be regulated in the same manner as paid panelists in other fields.

Both these proposed changes are aimed at making the most of existing resources. The form is already in existence. Completed signed copies of the form need to be in the hands of the Valuation Section of the IRS to formulate a clear statistical picture of non-cash charitable deductions over $5000 and to pinpoint those who use and misuse the provision. With these statistical controls, appraisers whose work is consistently acceptable can be noted, and those who continually inflate values can be notified that their appraisals are no longer acceptable to the IRS. . Together with the continuing conscientious review by highly qualified panels and the permanent members of the IRS Valuation Section, this information will help perpetuate the flow of art from private owners to public collections where they ultimately benefit us all.

Statement from David Nash

Director of Fine Arts

Sotheby's

International Fine Art Auctioneers

1. I have served on the IRS Art Advisory Panel for the last two years and have attended the past four sessions.

2. From its inception in 1968 I felt that the presence of an expert representative from the auction field was necessary as the basis of reference for almost all the valuations discussed by the panel is the published auction price. Prices at which paintings are sold on the private market are seldom if ever public knowledge and the IRS depends heavily on the information supplied or published by the leading international auction galleries. It was with great pleasure, therefore, that I received an invitation from Ms. Carolan to serve on the panel in 1984.

3. I feel that my principle contribution to the effectiveness of the panel comes from my knowledge of the fluctuations of the art market. My expertise has been acquired in working for the last 25 years at Sotheby's principally in the field of appraising and selling valuable paintings.

4a. In my view The Art Advisory Panel serves an extremely valuable function in its capacity to advise the IRS on valuations submitted by taxpayers. The panel gives its recommendations on the accuracy and fairness of appraisals submitted and attempts with considerable success in my opinion, to give orderly and professional advice to the IRS. Their recommendation to reduce inflated valuations made for donated purposes has amounted to $54 million in the past 8 years and their increased valuations on paintings that have been underestimated in order to minimize Estate Taxes have benefitted the IRS by another $60 million. The cost of the panel to the IRS must be minimal as the panelists receive no compensation and serve on a voluntary basis.

4b. The advantage to the taxpayer is less visible except insofar as the burden for all taxpayers is more fairly distributed if one section of the public pays its just share and abuses are curtailed.

4c. The benefit of the AAP to the arts community as a whole is subtle but important. Several of the world's greatest museums are in the United States and American interest in the visual arts is enormous and growing. I understand that the number of people visiting museums across the country now exceeds the number of people who attend spectator sports. The object of their interest is the collection of art exhibited by these museums and it must be remembered that these collections have been formed over a very short space of time. The arts community has benefitted from one of the most innovative and creative sources of supply of works of art in the world, the tax deductable donation. This system has enabled American Museums to compete successfully with the older museums of Europe where no country has such a generous scheme for encouraging collectors to give important paintings to their nation's museums in return for a tax concession. The orderly maintenance of this inducement is greatly in the interest of the museum going public and the existence of the IRS reviewing panel ensures that the system remains free of abuse on the part of donors.

5. In my experience the reviewing process of the AAP has been extremely effective in enabling the IRS to curb and to reduce the overvaluation of charitable contributions and to appraise at their proper values works of art which are itemised for Estate Tax purposes.

6. In view of the fact that the AAP does not know the name of the taxpayer nor his appraiser nor to which institution the donation has been made, no information of this sort can be determined.

7. The process for reviewing the valuation of a work of art is similar in every respect to the disciplines employed in making original appraisals, namely i) is the painting or sculpture by the artist it is supposed to be by - is there any doubt about its authenticity? ii) is the medium and/or material correctly described? iii) is it an important work by the artist? iv) does its condition have an effect on the appraised value? v) are the comparable sales prices cited by the appraiser accurate comparisons or are they carefully selected to provide a distorted figure? vi) is the work in question commercially attractive and desirable or is its market limited?

8. In the event that a painting or sculpture comes before the AAP which one of the panelists has appraised, that panelist must exempt himself from any discussion of its value and leave the room in order not to influence the fellow panelists in their determination.

9. The one area in which I could see room for improvement is additional equipment to provide better copies of the photographs submitted by the taxpayers and the availability to the panelists of good quality photographs of the items cited as comparable examples. In addition, the taxpayer could be obliged to provide more complete information about the work of art submitted for review and in cases of dispute with the AAP, possibly the work of art itself.

10. In my experience the effectiveness of the AAP has become common knowledge to those submitting appraisals for Estate Tax or charitable deduction purposes and the abuses of the past are now quite rare.

11. I think only irresponsible appraisers should be held accountable for over or undervaluations.

12. In the few experiences I have had in this respect judges tend to split the difference in cases of disputed valuations.

STATEMENT OF ALEXANDRE P. ROSENBERG, PAUL ROSENBERG & CO.

I am invited to present some remarks on the purpose, functioning and performance of the Art Advisory Panel of the Commissioner of the Internal Revenue Service as seen from the viewpoint of a panelist and of a long-time professional menmber of the art community.

My name is Alexandre Rosenberg, I am a New York dealer in fine art, associated for the last forty years with the firm of Paul Rosenberg & Co., the last twenty eight years as its sole director. The firm is a family business first established in Paris, in 1878 by my grand-father.

I have served on the first Advisory Panel for three and a half years starting in 1968 and I am currently serving a second term, which began in April of 1985.

I believe that the panel can be best understood by placing it in historical perspective. In the nineteen-sixties, due to the steady rise in art prices and the high rate of taxation, there appeared mounting evidence of widespread abuses in the form of over-valuation of donated works of art and to some extent also of under-valutation of works of art listed on estate tax returns, abuses attributable to ignorant or unscrupulous appraisers. The situation was sufficiently serious as to justify some alarm that, unless it was corrected, Congress might simply abolish the deductibility of art gifts. It had been, indeed, one of the first major concerns of the newly formed Art Dealers Association of America, of which I was elected the first president in 1962 and for a second term in 1976, because some dealers were suspected of issuing inflated appraisals as an inducement to buyers or of yielding to the pressure of clients to obtain high valuations under explicit or implied threats of withdrawing their patronage. In response, the Association made it a condition of membership that members desist from appraising individually and that all appraisals be issued in the name of the association based on the findings of a panel of three members, the identity of which would not be disclosed to the donor and the identity of the donor be withheld from the panelists. This system of appraisal, which is known to and approved by the I.R.S., has functioned smoothly and reliably ever since.

However, this act of self-policing could not correct the whole situation as many dealers were not admitted to the association or declined to join, and as a host of other appraisers were operating outside of the purview of the association. It is at this point that a joint delegation of the Art Dealers Association and of the Association of Museum Directors went to the I.R.S. in Washington to impress 1) that a mechanism for reviewing the appraisals was absolutely needed 2) that the I.R.S. has no competence of its own in artistic matters and had no expectation of either training its own experts or hiring from the outside

valid existing experts. The solution advanced was the suggestion that an advisory panel be created, of which the members, ten or twelve in number, would serve voluntarily and without compensation for the public good, and which would be comprised in more or less equal parts of museum personnel (directors or curatorial level), art historians and dealers, the three classes in whose ranks the most likely qualified individuals could be found. May I point out that as a result of the lack of expertise of the I.R.S. in this field, some perfectly accurate appraisals were challenged for no good reason and honest donors unduly harassed, while appraisals two or three times higher than reality were accepted or merely trimmed down by a small percentage, generating a large measure of resentment and distrust. The Art Advisory Panel was instituted in 1968 and soon contributed to restore a more orderly state of affairs.

Having served then on the panel and serving again now after a fourteen years interval, I am in a position to measure how the management of the panel has evolved. The beginnings had been sometimes difficult as could have been expected of untested procedures and of a permanent staff new to its duties. The material submitted to the panelists was raw, with few information and accompanied by photographs of very poor quality (I understand that the production of the necessary duplicates was at that time entrusted to one of the military facilities of the government). Elaboration of the data required considerable independent research on the part of the panelists and frequently a great effort of imagination and guess-work. Also, I had the impression that the choice of cases selected for submission to the panel was not always judicious. Returning to the panel last year, I was pleasantly surprised to find a dramatic improvement and so expressed after the working session of last April. The data submitted is now complete and to the point, the results of some initial research are supplied, as for instance the record of auction sales of comparable objects of art, and other various pieces of relevant and useful information. The quality of photographs is better and a larger proportion is in color, although I shall have to come back to this question when I consider possible improvement. More importantly, the staff has developed a surprisingly sophisticated understanding of the workings of the art world, private dealing, auction sales, methods of museum acquisitions, etc. as well as familiarity with the reputations and singularities of a great many of the personalities making up the American art scene. This is specially important regarding appraisers who, I feel, have been by now fairly graded in terms of their reliability. A basic reference library has been assembled. Lastly, there is seldom in the packages prepared for the study of the panelists cases unworthy of scrutiny. All these points result in a greater economy of time, better efficiency and much smoother functioning. Altogether, I judge the Art Advisory Panel, as it is today, a serviceable, effective instrument that does substantially the job for which it was designed, notwithstanding that, of course, no claim to perfection is made here.

On the side of the panel itself, as distinguished from the permanent administrative staff which runs it, it is clear that the pannel cannot be better that the panelists who compose it. So far, I believe that the recruiting has

been consistently well-advised. Someday in the future, there may arise a problem about filling the seats because the number of genuinely qualified experts is not unlimited. I would recommend having no hesitation at asking that panelists who have already served in the past serve again after a suitable period, and I do not think, judging by the willingness generally shown by candidates, that many would balk at a second term without good reason.

The qualifications required from a panelist are two-fold. He or she must be knowledgeable and experienced, preferably a long experience, in definite fields of art. True experts are necessarily specialized as art is much too vast and complex a world for any one person to know it all. There is no such being as an "art expert", only experts in certain forms or periods of art. Any claim to the contrary should be ignored. As a result, the panel should be made of a blend of various experts representative in their diversity of the balance of the categories of art coming up for review. To avoid an excessive fragmentation, however, and to insure that more than one panelist can act on each work of art under examination, experts with too narrow a focus of knowledge should be avoided and those with a reasonably wide field of experience preferred. The second qualification is that he or she be impartial. Fortunately, conflict of interest is almost never a serious problem as nobody has really anything to gain or lose personally by appraising for the panel. In the instances when a panelist happens to have made the valuation under review, or, if a dealer, has sold the object , or, if a museum person, his or her institution is the recipient of the object, the rule in effect is that this panelist be excused form the debate and leaves the room while the issue is discussed. Moreover, the term of office of the panelists is too short to permit the establishment of influence schemes. In fact, the selection of candidates for the panel is not difficult. The art world is not so large that reputations, both for knowledge and for integrity, are not readily apparent. Besides, if needed, the Association of Museum Directors, for museum personnel, the College Art Association for scholars and the Art Dealers Association of America for dealers are able to advise the I.R.S. much as the American Bar Association advises on the qualification of prospective judges.

Perhaps this is the place to give some indication of the process by which a panelist reaches the determination of the value of a given object. I have to admit that it is by no means simple or cut-and-dry. None of the common factors governing the market value of other types of property or commodities, such as material cost of production, cost of labor, cost of distribution, rate of amortization, applies to works of art. Rarity, which is measurable, contrary to some belief is not in itself an important factor as it is for postage stamps. It will never confer a high value to an object if this object is not intrisically of great artistic merit to start with, regardless of how many similar examples may or may not exist. In fact, there is something almost radically unnatural in applying calculus to things as intangible in purpose, as complex, as significant of high human achievements as works of art. Yet, the art market exists, pictures and sculpture are traded for money and some kind of equation must be found. This is why life-long experience is mandatory and experts needed to sort out the infinite nuances that make up artistic

merit. This is also why some differences of opinions are to be expected, demanding that the panel be large enough to permit reconciliation of these differences.

The first and perhaps most important task for a panelist consists in deciding whether a work of art is authentic, which means that it is in fact what the donnor's appraiser alleges it to be. In the negative, there is no point in going further : imitations and forgeries have but nominal value, good copies only a little more. Making such a decision requires the qualities grouped under the appellation of "connoisseurship", which includes familiarity with an artist's work, knowledge of historical documentation and supremely an exercised eye for quality. It is naturally dependent on what the photograph reveals and the larger, sharper and more detailed it is, down to a clear image of signature and brushstrokes for paintings, the more assured will be the decision. This crucial point has already been mentioned and will be addressed again later.

The second task is to define the range of prices obtained in actual sales for works by this particular artist around the time of the donation, collected from auction records,knowledge of ascertainable private transactions and general sense of the market, and then to place the work under review at its proper place in that scale by virtue of its size, importance, quality and a few other factors, notably its state of preservation. There again, the same aptitude of "connoisseurship", difficult to codify, is needed, which is finally a function of the learning and experience of the expert. Sometime the range of possible values is narrow, sometime it is very wide. While no two works of art are exactly alike, it is very often practical to find similar objects or objects closely comparable which have, around the time of the donation, been traded at a known price in situations conforming to the I.R.S. definition of "a willing seller and a willing buyer", and to adopt that price as a basis for value. It is the easiest cases and then almost anyone could appraise with acceptable accuracy, but mainly it applies to works of art of a routine or standard character, which are the most numerous but the least valuable. For more distinguished works, it is frequently difficult to find a relevant analogy among the recorded sales, as this class of works, the most expensive, tends to increase in rarity as the level of quality rises. There is a pyramid effect. Some interpolation and extrapolation have to take place. Wider and wider categories have to be resorted to. At the limit, never really attained, there stands the absolutely unique work for which no term of comparison and no experiential data exist. The nearer this extreme situation is approached, the more reliance has to be placed on the enlightenment and sense of cultural forces possessed by the panelist. If this may sound like a fanciful process, it is in practice surprising how easily a consensus develops among knowledgeable experts in the course of the discussion, perhaps a proof that some rationality is never absent from any human inquiry, even in the most exalted domain of aesthetics. I am not prepared to gauge exactly the degree of precision of the valuation system just described. In the more usual and simpler cases, it can be absolute ; in the more complicated or exceptional cases, the indetermination could be ten or twenty percent. At any rate, in the hands of able and experienced assessors, it does not compare unfavorably with

any of the other domains where life demands that judgments of value be made.

Is this system capable of improvement ? In itself, the process of appraisal cannot be different in kind, it can only vary in quality. The principal consideration is to keep the caliber of the panelists as high as possible, and it can be kept very high from the existing national resources. Scholarship has made and is making considerable strides and so has the dissemination and availability of information. Most of the other practical improvements have been brought in effectively by the new regulations that became effective this year. They include a tightening of the definition of "appraiser" under which no longer can anyone call himself or herself by that name just by saying so. Instead some credentials are to be produced. In addition, possible prosecution is provided for fraudulent or conspirational appraisals, and plain disqualification in case of habitual errors, even in good faith. This should decrease the instances of abuse and drive away incompetent appraisers. Second, the responsibility of the institutions which are recipient of donations is engaged by having to sign the acceptance of the donated object as described on the donation form. This should reduce the cases where a museum accepts unworthy material for political reason or accommodation of the donor : it has now to state in effect that the object given enters its permanent collection, not just become buried forever in the basement. Third, fines and other penalties are set on the donor for too large discrepancies between appraised value and real value. Finally, appraisers who may have been personally connected with recent sales of the donated object, especially sale to the donor, or who are associated with the recipient institution are barred from appraising. This eliminates an important source of conflict of interests. All these improvements are well-advised and welcome, and come close to fulfill what can be done in this domain. They are, however, too recent to have already born fruit.

It leaves the question of the most important tool which the panelists use in their task : the photograph attached by the donor to his or her tax return. I must say that in many cases the quality is sorely deficient and therefore confers to the system a weakness which cannot be completly overcome, regardless of the virtuosity of the panelist. It is the most probable cause of any misjudgment. Too often, donors supply a blurred snapshot of the object, by instance of a painting hanging on the wall and taken at an oblique angle to avoid the glare of the flash. It may even be sometime intentional. Deciding on this basis if a work is an original and what are its exact quality and state of preservation can be a rather acrobatic feat of mind. When thousands of dollars are claimed in deduction by donors, it may not be immoderate to impose on them the expense of a large photograph of professional quality, possibly in the form of a color transparency, which would probably be deductible in any event, or else disallow the deduction. More severe technical burdens are commonly imposed on taxpayers in many other respects. By the way, judging from photographs, although experts are trained to do so, is not an ideal method, but logistic and insurance problems make it a necessity. However, in the rare cases when a determination is impossible without access to the original, the I.R.S. should request that an actual viewing be somehow arranged.

The question may be raised, whenever the findings of the panel end up in a tax court,whether the legal department of the I.R.S. can stand up to the often high-power attorneys representing the tax-payer. I believe so because the I.R.S. can muster teams of expert witnesses of a stature difficult to match by the adversary. If judges so frequently resort to simply cutting the difference in half, it is a result of their general insecurity with problems of art, not of the superiority of the opposing attorneys. Good expert witnesses, by being asked the right questions, can deliver a sort of education on the job to the court. Usually, the tax-payer's lawyer does not understand art any better than the government attorney.

To conclude, I would like to consider whom in the community does the work of the Art Advisory Panel benefit. The answer, in my opinion, is that it benefits everybody worth benefitting. The I.R.S. is the most obvious beneficiary since the disallowance of deduction or the upgrading of assets in an estate results in the collection of additional revenue. It is an instrument of tax-fraud repression. I am not in a position to place a dollar value on the sums so retrieved as I cannot keep a tally, but the I.R.S. surely has complete statistics on this point. My feeling is that each work session yields a gain expressible in millions of dollars.

For the same reason, I can only surmise whether the instances of abusive or fraudulent valuations are regressing as a result of the existence of the panel. I conjecture that it is so because the deterrent effect can only act in this direction, but the I.R.S. can answer more precisely. The new regulations outlined previously, which further discourage abuse, have not yet had an effect, but there is no doubt that they will go another big step toward restraint. In this respect any campaign to remind tax-lawyers, accountants and other tax-payers' advisors of the regulatory role of the panel would not be a wasteful effort.

Museums and other donee institutions are also clear gainers. A credible and healthy administering of the regime of donations is the surest guarantor that the deductibility feature stays in the tax law. For many years now, and increasingly, gifts have been the most potent, if not the only means of acquisition and enrichment of public collections. Their collective future is greatly dependent on this channel of private contributions remaining open. In that sense, any malfunctioning jeopardize their vital interests. This is very well understood and accounts for the large cooperation always extended by museums to the panel.

Private owners of works of art are well served by being able to rely on the deduction principle and also to deal with an orderly, reasonable, predictable machinery rather than the confused, capricious and often harassing behaviour of the I.R.S. and its field agents characteristic of former times. I have never heard from collectors any adverse comment against the panel, of which the necessity is generally well understood and accepted. On another plane, the review of valuations works both ways. It happens that an appraisal is low or that an estate has overvalued an item, for instance when executors believe they have an original when they merely have an imitation. The panel says so. I do not know what the I.R.S. does in that case, but it could be in principle an important protection for the tax-payer. To be sure, there has to be collectors who would

prefer more laxity and who regret the vanishing opportunities of tax-dodging, but I do not think that it is the kind of interests this committee takes into consideration.

Dealers have from the start welcome the institution of the Art Advisory Panel. Like museums and collectors, who are their clients, dealers find their best-understood interest in operating in an orderly market and under a legislation which underwrites flourishing museums and reassured collectors. Besides, they have every reason to enjoy the elimination of any ground of suspicion that they could be accessory to tax-fraud, as it used to weigh on them, as well as the removal of the pressure of some collectors that they produce favorable appraisals. It is a common misapprehension to believe that dealers defend the deductibility of art gifts because it is an incentive to collectors, as they can give to a museum advantageously. This would be true if works of art were an endlessly replaceable commodity. Today's major problem for dealers is the dwindling supply of good art. They would much prefer that collectors sell, rather than give, thus recycling such art, rather than seeing it removed from the market into a permanent institution.

As to the general public, it is not directly interested in the problem of appraising the donations of works of art and only a small fraction might be interested in valuing art for estate tax returns. Yet, more broadly, it is certainly a legitimate concern of eveyone that tax dollars are duly collected and evasion curbed. On the other hand, in this age of dramatically mounting popular interest in art, the existence of powerful museums has become a necessity for any enhancement of the quality of life. Admissions to museums throughout the nation testify to the enormous surge of art consciousness on the part of the general public. Internationally, the appeal is just as great. The principal attraction for foreign visitors and tourists, and the attendant source of prestige, are surely the excellence and richness of the American museums. This is a surprising development for a country which, a hundred years ago, was despairing of ever emulating the great European collections and was advocating in Congress the commissioning, for public education, of copies of famous paintings and plaster replicas of famous sculpture because they thought that originals were out of reach. Today, a degree of parity has been achieved with Europe. Such an invaluable benefit to culture is directly assignable to the generosity of American collectors and to the wise regime of donations which encouraged it. In its regulatory function which helps maintaining the flow of art into public collections through a sane system of contribution, the Art Advisory Panel assists significantly the public welfare.

It is quite evident from this statement that I have little but praise for the Art Advisory Panel of the Commissioner of the Internal Revenue Service and that I am well satisfied of having participated in its work. As a taxpayer, if I were told that all other sectors of government have a comparable organ of control, I would feel considerably comforted.

I shall be glad to answer questions on any point not covered in this statement.

Alexandre Rosenberg

May 27, 1986

STATEMENT OF ROY SIEBER, ASSOCIATE DIRECTOR FOR COLLECTIONS AND RESEARCH, NATIONAL MUSEUM OF AFRICAN ART, SMITHSONIAN INSTITUTION

My name is Roy Sieber. I am an art historian with a Ph.D specializing in African Art. I am the Rudy Professor of Fine Arts at Indiana University and the Associate Director for Collections and Research at the National Museum of African Art, Smithsonian Institution. I have served as a consultant and advisor to the Indiana University Art Museum for more than 20 years. In this statement I shall address the questions sent by the staff of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives.

1. How long have you served on the Art Advisory Panel? Is there any period during which you did not serve?

   I have served on the IRS Art Advisory Panel for African, Oceanic, Pre-Columbian and Indonesion art continuously since June, 1984. I have attended all scheduled meetings.

2. How were you selected to serve on the AAP?

   I presume I was selected for the Panel because of my expertise in African art and a long-standing concern with museums and collectors. (I am myself a collector in a modest way.) I have published articles and catalogues, arranged 3 major traveling exhibitions of African art with accompanying catalogues: one at the County Art Museum, Los Angeles; one for the Museum of Modern Art; and one for the American Federation of Arts. I have been President of the Arts Council of the African Studies Association. I have served as consultant to a number of museums including the Detroit Institute of Art, the Fort Lauderdale Museum, Duke University, the High Museum in Atlanta, the Indianapolis Museum of Art, the Seattle Art Museum, the Carnegie Institute and the Field Museum in Chicago. For about 30 years I have known collectors and dealers, followed the auction sales and market trends, partly from self-interest but in major part to advise purchases by museums, such as Indiana University Art Museum and the National Museum of African Art.

   I should add that the IRS has consulted me, both formally and informally, since about 1975. I have also served as an expert witness on a number of occasions, once in a tax trial (Ralph and Virginia Neely v. Commissioner of Internal Revenue, 1985. Docket Nos. 24184-81, 26934-82.) See below Sub Question 12.

3. Why did you choose to serve on the AAP?

   Aware of the problems of over-and-undervaluations that had taken place and my years on contact with the African Art market, I felt I could be useful. I must admit to a sense of indignation at certain practices I had observed in the overvaluation of museum donations.

4. How in your view do each of the following benefit from your service on the AAP?

   a. The IRS benefitted from my knowledge of the field and the market in reviewing evaluations put to the Panel by the IRS staff. I should note that the Primitive and Pre-Columbian area of the Panel was a very well selected group. In each of the African and Pre-Columbian areas an important and respected dealer and a well-known

scholar offered balanced views. The fifth person was the head of a major museum department and an Oceanic specialist. All 3 of the scholars knew the market and both dealers were strong in academic concerns.

As discussed under Question 7 the committee approached each work with a concern for its authenticity, typicalness rarity and aesthetic quality in reaching a determination of its valuation. The exchanges were lively and informative, the conclusions usually a concensus. Of particular note is the number of Oceanic and African pieces that are not genuine traditional examples and seem often to have been misvalued by the taxpayers' appraiser.

b) Taxpayer -
The process, which for the Primitive and Pre-Columbian area of the Panel, is quite recent having begun only in 1984, is beginning to have an impact on donor taxpayers. They seem concerned on two counts. First, to ask which appraisers are 'trusted' by IRS and, second, the assumption that all valuations will be challenged. It seems hard to convince them that the IRS and/or Panel is not out to get them or that it is not the appraiser who is judged but rather the accuracy with which the appraisal reflects the market value of the donation. In sum the donor taxpayer should, in part from my services on the Panel, be warned against excessive valuations and in the process realize that the larger taxpaying public will gain from the more reasonable evaluations that that the museum-going public will gain from the appearance of respectable, genuine donated works of African, Oceanic, Pre-Columbian and Indonesian objects in exhibitions.

c) Arts community as a whole -
The arts community benefits from the Panel, and in part, from my service, through the check on donations of fraudulent examples or pieces of inferior aesthetic merit. The presentation, of fraudulent tourist or inferior works in museums tends to misrepresent and therefore falsify the real merits of the art.

5. What is your opinion of the overall effectiveness of the AAP?

The Panel was expanded only in 1984 to include the African, Oceanic, Pre-Columbian and Indonesian areas. Thus my conclusions are most tentative in view of the short time we have been functioning. However, it has rapidly become clear that the cases we have examined represent only the tip-of-the-iceberg. Many more cases need reviewing than are brought to the attention of the Washington IRS staff. Indeed, there is more than enough to keep a much larger staff busy, and possibly more than could be handled by the existing Panel in its one-day meetings twice a year.

At the same time discussions with some concerned public lead me to believe that an impact has been made and that future donations will be more cautiously and realistically valued. In 1984 and 1985 the Primitive and Pre-Columbian area reviewed 1,464 art works with a total claimed value of over $11.3 million. Recommended adjustments represent an average overvaluation on each overvalued item of 1,959% for 1984 and of 571% for 1985. The donations thus far reviewed by the Panel have all fallen well before 1984, the year

the Primitive and Pre-Columbian area of the Panel was appointed. Thus the figures do not show the impact of Panel deliberations. However those figures will prove useful as the basis for discerning trends of valuations after 1984.

In short it is too early to tell with objectivity the effect of the Panel on Primitive and Pre-Columbian art valuations.

6. Have you discovered through the work of the AAP any of the following:

   a) that certain appraisers have been identified as consistently providing overvaluations to the taxpayers?

      Through the work of the Art Advisoty Panel it seems clear that certain appraisers consistently provide overvaluations to the taxpayers. At times fraudulent or tourist items are valued as if they were not only real but of exceptional quality. In other instances, pieces that are genuine but aesthetically indifferent are valued as if they were masterpieces. In short, the judgment of certain appraisers is open to serious question.

   b) that certain museums tend to be recipients of art contributions that are overvalued?

      Small museums which lack expert knowledge on their staffs tend to be the recipients of questionable donations. Such museums often display naivete with regard to the genuiness and aesthetic worth of the objects they accept. They tend to accept the appraiser's identifications and descriptions (and valuations) uncritically. Because the museums do not necessarily know the market they can be innocent parties in cases of overvaluation. An excellent examples is the University which accepted the gifts described in the Neely case under 12.

      To the best of my knowledge the AAP has not uncovered any tax shelter schemes in the Primitive and Pre-Columbian area.

7. What type of determinations do you make when art work is put before you? What questions do you ask yourself when making a valuation?

   The determinations I make concerning an artwork from the Primitive and Pre-Columbian area consist of several points of examination and consideration.

   a) Authenticity: is the piece a genuine artifact produced by the right people in the right place at the right time for their own use, and so used?

   b) Is it stylistically and morphologically correct? Does it represent the usual size and usual form of the type?

c) What evidences of age and use exist? The results of age and handling are often called patination. The presence of the correct sort of patination is proof that the work was accepted and used within its parent culture.

d) An evaluation of the aesthetic quality of the work, how skilfully made, what formal qualities does it possess? This is the most subjective of these determinations and is the result of the examination and study of many works over a long time.

e) What is the collector/museum demand for examples of the type; how rare is it?

Now, when a work is determined to be genuine, stylistically and morphologically correct and with the proper evidence of age and use, it is finally the aesthetic judgment and consumer demand that determine the difference between a routine or indifferent piece and a masterpiece. And in the final sense it is the quality of a genuine piece along with its rarity that determine its market value.

8. Have you ever had a conflict of interest, i.e., your knowledge of the purchase or sale of the taxpayer's contribution, in your experience as a Panelist? How was it handled?

The IRS staff have proved to be excellent in recognizing cases of possible conflict of interest. The Panel member concerned excuses himself from the room for the duration of the discussion concerning the case. Occasionally the Panel member will have other knowledge of the piece and will, in that instance, remove himself from the discussion. At the same time, many pieces are well known, often illustrated, and a knowledge of the donor or the museum is not, of itself, a conflict of interest.

9. What can be done to improve the AAP?

The procedures of the AAP seem effective; the system seems to work well. To improve the Panel would necessitate the bringing of more cases before it. That would, of course, necessitate IRS staff to cope.

10. Can anything else be done to further curtail abuse in this area, i.e., overvaluation?

Possibly the $20,000 valuation level for mandatory screening by the Panel, could, in the case of African, Oceanic, Pre-Columbian and Indonesian works of art be reduced, even to $5000. This would send a sharp warning to appraisers and taxpayers that overvaluation will not be tolerated. In my observation of objects referred to the Panel, the area of greatest overvaluation of African objects exists in the $5000 to $20,000 range. Again, the existing staff of IRS appraisers would need to be enlarged.

11. Should anyone outside of the appraiser be held accountable for the valuation of charitable contributions?

In addition to holding the appraiser accountable for the valuation of charitable contributions, the taxpayer/donor should be held accountable, particularly when there is a gross discrepancy between the taxpayer's cost and the valuation.

12. Do you feel the IRS can hold its own in the courts against the high-powered attorney of the taxpayer? Do judges recognize the IRS position on valuations or do they tend to merely split the difference between the taxpayer and the IRS?

In my own experience with tax trial, I found that the IRS held its own very well and that the judge was most attentive to the IRS lawyer. The judge did not split the difference between the valuation of the taxpayer and the IRS.

The case was Ralph and Virginia Neely v. Commissioner of Internal Revenue, 1985 (Docket Nos. 24184-81, 26934-82). The judge listened carefully to both sides and, was most attentive to my testimony an an expert witness. I should add that the case presented an unusually large percentage of tourist pieces and copies. In sum, I reviewed about 121 works that had been donated to Duke University (another 321 had been donated to Duke and to other institutions). By far the larger part, approximately 80% were not genuine and those that were, were of poor or mediocre quality.

The judge held that the IRS valuations were sustained and those of the taxpayer rejected.

Summary: (total of 442 works)

Taxpayer's valuation	$1,503,105.00
Taxpayer's cost	$91,726.00
IRS valuation	$167,855.00

13. Do you have other suggestions of people that we can talk with outside of the AAP who can provide additional viewpoints?

I can suggest two other people that Committee staff can talk with.

Dr. Ernst Anspach 118 West 79th Street New York City	A collector and donor, now retired.
Michael Kan, Associate Director Detroit Institute of Art Detroit, Michigan	Museum director and expert in Primitive and Pre-Columbian arts.

STATEMENT OF THE AMERICAN ASSOCIATION OF MUSEUMS AND AMERICAN ARTS ALLIANCE, PETER MARZIO, DIRECTOR OF THE MUSEUM OF FINE ARTS, HOUSTON, TEXAS

Mr. Chairman and Members of the Committee:

On behalf of the American Association of Museums and American Arts Alliance, we appreciate this opportunity to testify before the Ways and Means Subcommittee on Oversight hearings on the Internal Revenue Service's Arts Advisory Panel and on other issues involving charitable contribution deductions for gifts of art.

Mr. Chairman, the issue of determining the value of gifts of art and other collectible items received considerable attention in 1984. At that time, several highly publicized incidents of the overvaluation of charitable contributions of property provoked great concern in the museum and cultural community as well as in Congress and the Department of the Treasury. The consequence of that concern was an 18 month period of intense discussion culminating in the enactment of tough new restrictions and requirements with respect to gifts of appreciated property.

As you know, Mr. Chairman, the Deficit Reduction Act of 1984 ("DEFRA") imposed new penalties and new substantiation requirements to begin on January 1, 1985. In general, DEFRA tripled the penalties for overvaluation of charitable gifts of property, mandated an appraisal with respect to property gifts of more than $5,000 in the case of art, historical and cultural objects and imposed stronger requirements on the content of the appraisal and the identity of the appraiser. The parallel approaches of the DEFRA provisions -- tougher penalties and stricter substantiation requirements -- specifically targeted the kind of overvaluation abuse that comes before the Arts Advisory Panel.

The new penalties not only raise the stakes for donors who would otherwise aggressively claim a high valuation, but the penalties also are imposed upon appraisers who help to secure the overvaluations. In addition, the substantiation requirements cover all gifts of significance and contain special safeguards to assure the expertise and independence of the appraiser. Equally important, the substantiation requirements explicitly prohibit appraisal fees based upon the amount of the appraisal except in circumstances where the individual appraiser cannot benefit personally from giving higher appraisals.

The American Association of Museums and the American Arts Alliance believe that the DEFRA provisions are a significant step forward in addressing the problem of overvaluation. We hope that the provisions resolve the problems. We were active and willing participants in the development of these rules, and are proud of the fact that we played a supportive and constructive role in their promulgation. In fact, the American Association of Museums joined with the Association of Art Museum Directors to prepare a brochure, entitled "Gifts of Property: A Guide for Donors and Musuems," that outlined in detail the new requirements. This brochure, a copy of which has been made available to the Subcommittee, was distributed to all members of the Association of Art Museum Directors, all museum trustee members of the American Association of Museums and throughout the museum community. Should the 1984 rules prove to be inadequate, however, we are prepared to devote further resources to improving the process.

We do feel strongly, however, that it is premature to talk about new measures at this point. Frankly, we are somewhat puzzled that the Ways and Means Committee on Oversight would hold oversight hearings before any data has been developed on the impact of the 1984 changes. So far as we know, the only Arts Advisory Panel data and general Department of Treasury data that exists is with respect to returns filed for taxable years that began prior to January 1, 1985, when the DEFRA provisions took effect. If information exists that reflects the 1985 changes, we would be more than willing to consider and comment on it. In the absence of such data, however, we think that oversight is premature. We note, for example, that the overvaluation of charitable gifts of art by the Arts Advisory Panel in the years prior to 1985 was approximately 37%. This level of overvaluation is by no means insignificant, but it should be emphasized that this level of overvaluation in years after the effective date of DEFRA would be subject to the tough new DEFRA penalties. In these circumstances, therefore, we believe the oversight function of the House Ways and Means Committee would be more effectively served by waiting for the release of the 1985 data.

Mr. Chairman, we would like to take this opportunity to raise with you what we consider to be fundamental policy issues that should apply to any system of policing overvalued gifts of appreciated property to charitable institutions. We believe it is essential that the donee institution have no role in valuing a gift or confirming the value assigned to it by the donor. The 1984 act requires the donee institution to acknowledge receipt of an object but does not impose an obligation to certify or in any way acquiesce in the value. Any relaxation of this strict standard of separation will inevitably compromise the process. In fact, incorporating the donee any farther into the appraisal process would raise such a strong perception of a conflict of interest that the entire process of tax deductible charitable contributions would suffer.

We also think it is very important to distinguish, but not excuse, the nature of the tax avoidance in overvalued gifts of property from the typical type of tax shelter avoidance. In the former, the taxpayer irrevocably gives away property and permanently reduces his or her net worth. In the typical tax shelter arrangement, the taxpayer acquires a property and holds an ownership interest in the property until it is sold -- often at a gain. It is true that each taxpayer is able to shelter income from tax by use of the gift or the investment. However, the cost of utilizing the tax benefit of making a charitable contribution of an art work is the permanent loss of the property and consequent reduction in net worth. By contrast, the investor in a limited partnership tax shelter investment continues to enjoy the benefits of ownership and the possibility of appreciation in value in addition to the tax benefits. This distinction in no way justifies the overvaluation of charitable gifts, but it does bear upon the type of response that is appropriate.

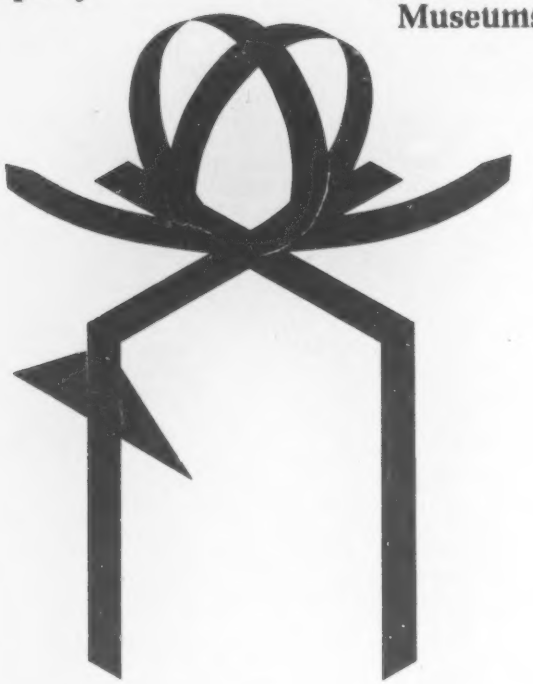
The most important policy consideration, however, is to develop a system that assures the accurate valuation of gifts of property without restricting gifts of artistic, historical or cultural importance. We are very fortunate in this country to have developed a series of museums, historical societies, zoological gardens and other institutions that preserve and

display objects of enormous beauty, historical significance and cultural value. Moreover, these exhibits are accessible to vast numbers of citizens, scholars and students. The overwhelming majority of the members of the American Association of Museums and the American Arts Alliance also conduct outreach programs within their respective communities to attract children and others to the facilities for educational and charitable purposes. The inducement to make gifts of property is an important factor in encouraging the collection of objects in public institutions. In effect, the current system efficiently provides for the wide distribution of art, historical and cultural objects from out of the hands of a small number of people into the reach of the average American. Clearly, such a system should not be tampered with carelessly.

To that end, it is crucial that changes be considered only after the best available information has been obtained. We believe that this opportunity will arise only after the impact of the DEFRA changes can be evaluated and analyzed. We hope, Mr. Chairman, that you share this prudent approach, and we promise to be available for any oversight that you deem necessary following such an evaluation and analysis.

Gifts of Property

A Guide for Donors and Museums



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Introduction

6 American museum collections are rich and diverse, compelling evidence of the generosity of generations of donors. Since 1917, the United States has acknowledged the public benefit of such gifts by providing strong incentives for them in the tax code. As a result, donations of art objects and cultural material account for more than 80 percent of the items in museum collections. People give to museums for a variety of reasons, but the availability of the tax incentive and the astonishing growth of museum collections in this century are indisputably linked.

Despite the demonstrable public benefit of the charitable deduction, it has proved to be an increasingly fragile part of our tax system. Recent efforts at tax reform have challenged the notion that the charitable deduction is sacred. The fragility of the deduction has been particularly apparent for donations of appreciated property. This deduction is regularly scrutinized by Congress because of its susceptibility to abuse through the overstatement of values claimed by taxpayers for their donations.

After a series of highly publicized instances of gross overvaluations of donations, Congress enacted a number of changes in the law designed to curb potential abuse. These include increases both in the substantiation requirements for gifts of property and in the penalties for overstatements of value. The changes are part of the Tax Reform Act of 1984 (Pub. L. 98-369 (96 Stat. 691)) and pertain to certain kinds of donations made to all nonprofit charitable organizations after December 31, 1984. Among those affected by the new measures are donors, museums and appraisers. The provisions are implemented through temporary regulations issued by the Internal Revenue Service on December 31, 1984. Although temporary, the regulations are in effect until final regulations are published.

The purpose of this publication is to inform museums and their donors about the changes in the law and the new responsibilities of donors and museums in giving and accepting gifts of appreciated property. Although all recipients of donations of property are potentially affected by the statute and regulations, the importance of this type of donation to museum collections highlighted the need for information directed at the museum community. The publication is a joint undertaking of the American Association of Museums and the Association of Art Museum Directors. Its primary intent is to enable museums and their contributors to continue a worthy practice in an ethically sound and legally correct manner.

The format of the publication follows the basic process of substantiating the value of a donation as required by law, outlining first the obligations of the donor and then the obligations of the museum as donee. The regulations from which this information is drawn, as well as the law that gave rise to the regulations, are printed in full at the end of the publication in the appendix.

The Compliance Process

The provisions of the Tax Reform Act of 1984 with respect to certain gifts of property should be understood within the context of the requirements for all charitable deductions. Regardless of kind or value, contributions made to a charitable organization must be substantiated. Whether a donor has given money to a worthy cause, old clothes to Goodwill Industries or a painting to a museum, the donor must be able to prove the fair market value of the gift, either through a cancelled check, a receipt or a letter from the donee acknowledging the gift. (The reference for these regulations appears in the appendix.) Although this proof may not have to accompany the donor's tax return, it must be available in the event of an audit by the Internal Revenue Service. This publication does not cover these long-standing requirements, but focuses solely on the types of property donations affected by the 1984 tax act.

Types of Donations to which the Tax Reform Act Applies 7

The law applies to any donation which meets both of the following criteria:

- it is a gift of property (objects and materials, nonpublicly traded stock, and real estate); and
- the value of an individual item or of a group of similar items exceeds $5,000, or, in the case of closely held stock, exceeds $10,000.

"Similar items" are defined in the regulations as "property of the same generic category or type, including stamps, coins, lithographs, paintings, books, nonpublicly traded stock, land or buildings." The definition is an important one to note as the parts of the regulations dealing with the substantiation of aggregated gifts of similar items are among the more complicated aspects of compliance.

The law does not apply to donations of cash or publicly traded securities as their values are easily determined.

8 To obtain a charitable deduction, donors who contribute either an individual item or a group of similar items worth more than $5,000 to one or more charitable organizations are required by law to obtain a qualified appraisal, executed by a qualified appraiser, and to attach a summary of the appraisal to the tax return for the year in which the deduction is first claimed. In addition, the regulations impose certain time and record-keeping requirements as well as penalties for failure to comply.

The purpose of the requirements is to assure that values are as accurate as possible and to encourage donors and appraisers to act in good faith in seeking and supplying this substantiation.

Qualified Appraisal

The law and regulations define a qualified appraisal in very precise terms. In fact, the key to the success of the law rests on the quality of the appraisal and the appraiser. The statute defines a qualified appraisal as a document signed and dated by a qualified appraiser (defined and discussed below) containing:

- a description of the property appraised;
- a statement of the fair-market value of the property on the date of contribution and the specific basis for the valuation;
- a statement that the appraisal was prepared for income tax purposes;
- the qualifications of the appraiser and
- the signature and taxpayer identification number of the appraiser.

The law also stipulates that an appraisal will not be considered qualified if all or part of the fee paid for it is based on a percentage of the appraised value of the property. The only exception to this prohibition occurs when "fees are based on a sliding scale . . . paid to a generally recognized . . . association regulating appraisers." The law thus recognizes the appraisal services offered by groups such as the Art Dealers Association of America, Inc., fees for which are paid directly to the association and not to the individual dealers or appraisers involved in the appraisals.

In addition to these basic requirements, the IRS regulations specify that the following information be included in the appraisal:

- a description of the property sufficiently detailed for a person not familiar with the contributed property to identify it;
- the physical condition of the property;
- the date (or expected date) of contribution to the donee;
- the terms of any existing or anticipated agreement or understanding between the donor and donee concerning the use, sale or other disposition of the property;
- the name and address as well as the taxpayer identification number of the qualified appraiser or any individual partnership, or corporation that employs the appraiser or acts on behalf of the donor;
- the qualifications of the appraiser, including the person's background, experience, education and membership, if any, in professional appraisal associations;
- the date (or dates) on which the property was valued;
- the method of valuation used to determine the

fair market value, such as the income approach, the market data approach, or the replacement-cost-less-depreciation approach;
- the specific basis for the valuation, if any, such as comparable sales transactions; and
- a description of the fee arrangement between the donor and appraiser.

Although a separate appraisal is required for each individual item valued at more than $5,000, only one appraisal needs to be obtained for a group of similar items of property that exceed the $5,000 threshold if they are contributed in the same taxable year. The information to be supplied for each item covered by an aggregated appraisal is the same as defined above for a contribution of a single item of property with one exception: "the appraiser may select any items whose aggregate value is appraised at $100 or less for which a group description will suffice."

The requirement that the appraisal include information on any existing or anticipated agreement concerning the disposition of the donated property is considered by some who have commented on the regulations to be both outside the expertise of the appraiser and immaterial to a determination of value. Consequently, as a result of comment, the requirement may be changed when final regulations appear. For the present, a qualified appraisal must include this information.

Qualified Appraiser

The most critical decision a donor will make in the process of obtaining a charitable deduction for a donation covered by the new statute is the selection of a qualified appraiser. Appraisers are now pivotal figures in this type of gift transaction. Their qualifications, independence and integrity are key to the ability of a donor to receive a deduction for his gift.

The regulations set forth five requirements, expressed in the negative, for an appraiser to be considered qualified. A qualified appraiser can **NOT** be:

- the donor;
- a party to the transaction in which the donor acquired the property being appraised unless the property is donated within two months of the date of acquisition and its appraised value does not exceed its acquisition price;
- the donee of the property;
- any person employed by or related to any of the above persons;
- any person whose relationship to any of the above persons would cause a reasonable person to question the independence of such an appraiser.

In addition, the regulations require that a qualified appraiser declare on the appraisal and appraisal summary that he:

- presents himself to the public as an appraiser;
- is qualified to make appraisals of the type of property being valued;
- does not fit one of the categories described in the regulations that would exclude him as a qualified appraiser; and
- understands that a false or fraudulent overstatement of the value of the property may subject him to a civil penalty.

The regulations covering appraisers offer indirect

assurances to both donors and museums. For donors, meeting the requirements with respect to a qualified appraiser is certainly a positive indication of "good faith" in the effort to arrive at the value of a charitable deduction. Evidence of good faith will help mitigate the penalties otherwise applicable if the deduction is successfully questioned by the Internal Revenue Service. For museums, the stipulation that an appraiser cannot be the donee strengthens their position that a museum ought not be a party to determining or verifying the values donors claim for gifts.

Appraisal Summary

The appraisal summary is a digest of the key information contained in an appraisal. The summary is prepared by the appraiser on the form prescribed and supplied by the Internal Revenue Service (see Form 8283 in the appendix). In order for a donor to receive a charitable deduction, the appraisal summary, signed and dated both by the appraiser and by the museum as donee, must be attached to the donor's tax return for the year in which the deduction is first claimed. A separate appraisal summary must be attached for each item that has been appraised. Where items have been aggregated for the purpose of obtaining an appraisal and all the items involved have been donated to a single institution, only one summary is required. In cases where donations to more than one institution have been aggregated for an appraisal, separate appraisal summary forms describing the items in each donation, signed by each of the museums involved, must be attached.

The regulations require that the following information be included on the summary:

- the name and taxpayer identification number of the donor;
- a description of the contributed property in sufficient detail to enable a person not generally familiar with the type of property to identify it;
- a brief summary of the physical condition of tangible property at the time of the contribution;
- a description of the manner of acquisition (e.g., purchase, exchange, gift, or bequest) and the date of acquisition; or, if the property was created, produced, or manufactured by or for the donor, a statement to that effect and the approximate date the property was substantially completed;
- the cost or other basis of the property;
- the name, address, and taxpayer identification number of the donee;
- the name, address, and taxpayer indentification number of the appraiser;
- the date the donee received the property;
- the appraised fair market value of the property on the date of contribution;
- a declaration by the appraiser regarding his qualifications, and eligibility (as described previously under "qualified appraiser");
- a declaration by the appraiser that the fee charged for the appraisal was not one that would disqualify it; and
- a declaration by the appraiser that he is not being penalized for previous invalid or overvalued appraisals.

The regulations enable donors to submit the appraisal summary to a museum for acknowledgment of the donation before much of the required information

is entered on the form. Only the name and taxpayer identification of the donor, a description of the property, a summary of its condition, the name and address of the museum and the date it received the donation need appear on the appraisal summary when the museum signs it. This enables museums to acknowledge only the substance of the donation, preserving the donor's confidentiality with respect to the appraisal and the basis of the valuation.

There are special provisions regarding appraisal summaries for gifts of closely held stock and for donations made by partnerships and corporations. The requirements are not described here in detail, but can be found in the regulations published in the appendix. Donations of real-estate and buildings conform to the requirements for donations of art and other cultural material.

Time and Recordkeeping Requirements

The following deadlines or time constraints are imposed on the appraisal process:

- to be considered qualified, the appraisal of the donation must be made no more than 60 days prior to the date of its contribution;
- the appraisal must be received by the donor before the due date (including extensions) of the tax return on which the deduction is first claimed; and
- the donor must retain the qualified appraisal in his records for as long as it may be relevant in the administration of any internal revenue law.

Penalties

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The statute and IRS regulations specify the following penalties for failure to value donations properly or to comply with the various provisions of the appraisal process:

- If the IRS finds that donated property is overvalued by 150 percent or more of what is determined to be its correct value, a flat penalty of 30 percent will be applied to the underpayment of tax that resulted from the overvaluation. Interest on the penalty may also be due. The IRS is permitted to waive the 30 percent penalty only if the donor claimed the value on the basis of a qualified appraisal made by a qualified appraiser and, if in addition, the donor made a good faith effort to arrive at the value.
- The donor's failure to attach the appraisal summary may result in a disallowance of the tax deduction. In this event, the IRS may request that the donor submit the appraisal summary within 90 days of the request. If the donor complies with this request within that period, the deduction will not be disallowed provided that the failure to attach the appraisal summary was a good faith omission.
- Any appraiser who falsely or fraudulently overstates the value of the property described in an appraisal or appraisal summary may be subject to a civil penalty for aiding and abetting an understatement of tax liability and consequently may have appraisals disregarded.

Requirements for Museums as Donees

12 For the first time, the internal revenue code and IRS regulations require donees to participate in the process of substantiating the donation of property. Although museums are not required to confirm the value of property at any point, they are now required both to acknowledge receipt of certain donations for which a deduction is claimed and to report to the Internal Revenue Service the value of any sales, exchanges or other dispositions of donated material within a two year period of the gift. The regulations that stipulate these requirements are described below.

Acknowledgment of Appraisal Summary

The law requires that the museum acknowledge the receipt of the appraised property by signing the appraisal summary. The regulations include the following requirements:

- The person who signs the appraisal summary for the museum should be an official authorized to sign the tax or information returns of the museum, or a person specifically and officially authorized by that official to sign appraisal summaries. Among the individuals who could be designated to sign appraisal summaries in museums are the registrar, members of the curatorial staff or the director.
- The signature of the museum acknowledging receipt of the gift represents that the museum has received the property described in the appraisal summary on the date specified, and that the museum understands its obligation to report any sales or exchanges or other dispositions that occur within the two years following. It does not represent concurrence in the appraised value of the contributed property even if the value appears on the summary. If, however, the museum believes there is a significant discrepancy in the description of the donated property that appears on the summary, this should be discussed with the donor.
- Museums must send the donor a copy of the report filed with IRS.

Recordkeeping and Reporting Requirements

Because of the provisions that now require museums to report certain sales and other dispositions of donated property to the IRS, museums must retain copies of appraisal summaries in their records for at least two years. As most museums maintain comprehensive records on acquisitions, this provision may at most require adjustments of existing practices. For gifts of closely held stock and real estate that fall within the regulations, recordkeeping procedures that enable museums to make their reports to the IRS in a timely fashion will need to be established.

The statute and regulations require that a donee report, on the form prescribed by the Internal Revenue Service (see Form 8282 in the appendix), the sale, exchange, or other disposition of property for which an appraisal summary has been submitted if the sale or exchange occurs within two years of the date of the property's contribution. Because museums generally

retain donations for much longer than two years, this reporting requirement should not greatly increase a museum's recordkeeping responsibilities. Nonetheless, when this provision does apply, the museum must be prepared to provide the following information to the IRS:

- the name, address and employer identification number of the museum;
- the name, address and taxpayer identification number of the donor;
- a description of the contributed property (or portion disposed of) in sufficient detail to identify it;
- the date of contribution;
- the date of disposition;
- the value received on disposition.

A copy of the report must be sent to the donor at the time it is filed with the IRS.

The museum must file Form 8282 with the IRS on or before the ninetieth day after the museum sells, exchanges, or otherwise disposes of property for which an appraisal summary was submitted.

If the museum is not presented with an appraisal summary in connection with a donation, there is no obligation to report to the IRS any subsequent dispositions of the property.

Penalties

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The museum faces a $50 penalty if it fails to provide the required information to the IRS. This penalty may be waived if it is established that it was due to reasonable cause and not to willful neglect.

Appendix

Regulations Relating to Charitable Contributions of Property

14 **Income Tax; Taxable Years Beginning After December 31, 1953; Deductions In Excess of $5,000 Claimed for Certain Charitable Contributions of Property and Information Returns by Donees Who Make Certain Dispositions of Donated Property**

Agency: Internal Revenue Service, Treasury.
Action: Temporary regulations.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. Section 1.170A-13 is amended by revising paragraph (b)(1) to read as follows:

§1.170A-13 Recordkeeping and return requirements for deductions for charitable contributions

* * * * *

(b)*Charitable contributions of property other than money made in taxable years beginning after December 31, 1982*—(1) *In general.* See paragraph (b)(1) of 1.170A-13T.

* * * * *

Par. 2. A new 1.170A-13T is added immediately following 1.170A-13 to read as follows:

§1.170A-13T Temporary regulations; recordkeeping and return requirements for deductions for charitable contributions (temporary).

(a) Reserved

(b) *Charitable contributions of property other than money made in taxable years beginning after December 31, 1982.*—(1) *In general.* Except in the case of certain charitable contributions of property made after December 31, 1984, to which paragraph (c) of this section applies, any taxpayer who makes a charitable contribution of property other than money in a taxable year beginning after December 31, 1982, shall maintain for each contribution a receipt from the donee charitable organization showing the following information:

(i) The name of the donee;

(ii) The date and location of the contribution; and

(iii) A description of the property in detail reasonably sufficient under the circumstances (including the value of the property).

A letter or other written communication from the donee charitable organization acknowledging receipt of the contribution, showing the date of the contribution, and containing the required description of the property contributed constitutes a receipt for purposes of this paragraph. A receipt is not required if the contribution is made in circumstances where it is impractical to obtain a receipt (e.g., by depositing property at a charity's unattended drop site). In all cases, however, the taxpayer shall maintain reliable written records with respect to each item of donated property that include the information required by paragraph (b)(2)(ii) of 1.170A-13.

(c) *Deductions in excess of $5,000 for certain charitable contributions of property made after December 31, 1984.*—(1) *In general.* This paragraph applies to any charitable contribution made after December 31, 1984, by an individual, closely held corporation, personal service corporation, partnership, or S corporation of an item of property (other than money or publicly traded securities) the claimed value of which exceeds $5,000. In the case of such a charitable contribution, no deduction under section 170 shall be allowed unless the substantiation requirements described in paragraph (c)(2) of this section are met. For purposes of this paragraph (c), the claimed value of an item of property is the aggregate claimed or reported value of such item of property and all similar items of property (as defined in paragraph (c)(7)(iii) of this section) for which deductions for charitable contributions under section 170 are claimed or reported by the same donor for the same taxable year (whether or not donated to the same donee).

(2) *Substantiation requirements.* (i) *In general.* Except as provided in paragraph (c)(2)(ii) of this section, a donor who claims or reports a deduction with respect to a charitable contribution to which this paragraph (c) applies must —

(A) Obtain a qualified appraisal (as defined in paragraph (c)(3) of this section) for such property contributed;

(B) Attach a fully completed appraisal summary (as defined in paragraph (c)(4) of this section) to the tax return (or, in the case of a donor that is a partnership or S corporation, the information return) on which the deduction for the contribution is first claimed (or reported) by the donor; and

(C) Maintain records containing the information required by paragraph (b)(2)(ii) of 1.170A-13.

(ii) *Certain nonpublicly traded stock.* In the case of nonpublicly traded stock, the claimed value of which does not exceed $10,000 but is greater than $5,000, a donor must—

(A) Attach a partially completed appraisal summary form (as described in paragraph (c)(4)(iv)(A) of this section) to the tax or information return specified in paragraph (c)(2)(i)(B) of this section; and

(B) Maintain records containing the information required by paragraph (b)(2)(ii) of 1.170A-13.

(3) *Qualified Appraisal*—(i) *In general.* For purposes of this paragraph (c), the term "qualified appraisal" means an appraisal document that—

(A) Relates to an appraisal that is made not earlier than 60 days prior to the date of contribution of the appraised property;

(B) Is prepared, signed, and dated by a qualified appraiser (within the meaning of paragraph (c)(5) of this section);

(C) Includes the information required by paragraph (c)(3)(ii) of this section; and

(D) Does not involve an appraisal fee prohibited by paragraph (c)(6) of this section.

(ii) *Information included in qualified appraisal.* A qualified appraisal shall include the following information:

(A) A description of the property in sufficient detail for a person who is not generally familiar with the type of property to ascertain that the property that was appraised is the property that was (or will be) contributed;

(B) In the case of tangible property, the physical condition of the property;

(C) The date (or expected date) of contribution to the donee;

(D) The terms of any agreement or understanding entered into (or expected to be entered into) by or on behalf of the donor which relates to the use, sale, or other disposition of the property contributed, including, for example, the terms of any agreement or understanding which—

(1) Restricts temporarily or permanently the donee's right to use or dispose of the donated property, 15

(2) Reserves to, or confers upon, anyone (other than the donee organization or an organization participating with the donee organization in cooperative fund-raising) any right to the income from the donated property or to the possession of the property, including the right to vote donated securities, to acquire the property by purchase or otherwise, or to designate the person having such income, possession, or right to acquire or

(3) Earmarks donated property for a particular use;

(E) The name, address and taxpayer identification number (social security number) of the qualified appraiser (or appraisers) and, if the qualified appraiser (or appraisers) is a partner in a partnership, an employee of any person (whether an individual, corporation, or partnership), or an independent contractor engaged by a person other than the donor, the name, address, and taxpayer identification number (employer identification number) of the partnership or the person who employs or engages the qualified appraiser (or appraisers);

(F) The qualifications of the qualified appraiser (or appraisers) who signs the appraisal, including the appraiser's background, experience, education and membership, if any, in professional appraisal

16 associations;

(G) A statement that the appraisal was prepared for income tax purposes;

(H) The date (or dates) on which the property was valued;

(I) The appraised fair market value of the property on the date (or expected date) of contribution;

(J) The method of valuation used to determine the fair market value, such as the income approach, the market data approach, or the replacement-cost-less-depreciation approach;

(K) The specific basis for the valuation, if any, such as any specific comparable sales transactions; and

(L) A description of the fee arrangement between the donor and appraiser.

(iii) *Effect of signature of the qualified appraiser.* Any appraiser (or appraisers) who falsely, or fraudulently overstates the value of the property described in a qualified appraisal or appraisal summary (as defined in paragraph (c)(4) of this section) that the appraiser has signed may be subject to a civil penalty under section 6701 for aiding and abetting an understatement of tax liability and consequently may have appraisals disregarded pursuant to 31 U.S.C. 330(c).

(iv) *Special rules*—(A) *Number of qualified appraisals.* For purposes of paragraph (c)(2)(i)(A) of this section, a separate qualified appraisal is required for each item of property which is not included in a group of similar items of property. Only one qualified appraisal is required for a group of similar items of property contributed in the same taxable year of the donor, although a donor may obtain separate qualified appraisals for each item of property. A qualified appraisal prepared with respect to a group of similar items of property shall provide all the information required by paragraph (c)(3)(ii) of this section for each item of similar property, except that the appraiser may select any items whose aggregate value is appraised at $100 or less for which a group description will suffice. See paragraph (c)(7)(iii) of this section for the definition of similar items of property.

(B) *Time of receipt of qualified appraisal*—The qualified appraisal must be received by the donor before the due date (including extensions) of the return on which a deduction is first claimed under section 170 with respect to the donated property, or, in the case of a deduction first claimed on an amended return, the date on which the return is filed.

(C) *Retention of qualified appraisal*—The donor must retain the qualified appraisal in the donor's record for so long as it may be relevant in the administration of any internal revenue law.

(D) *Appraisal disregarded pursuant to 31 U.S.C. 330(c)*—For purposes of this paragraph (c), an appraisal shall not be a qualified appraisal if the appraisal is disregarded pursuant to 31 U.S.C. 330(c), unless the appraisal summary related to the appraisal includes a declaration as described in paragraph (c)(4)(ii)(K)(2) of this section.

(4) *Appraisal summary*—(i) *In general.* For purposes of this paragraph (c), except as provided in paragraph (c)(4)(iv)(A) of this section, the term "appraisal summary" means a summary of a qualified appraisal that—

(A) Is made on the form prescribed by the Internal Revenue Service;

(B) Is signed and dated by the donee (as described in paragraph (c)(4)(iii) of this section);

(C) Is signed and dated by the qualified appraiser (within the meaning of paragraph (c)(5) of this section) who prepared the qualified appraisal (within the meaning of paragraph (c)(3) of this section); and

(D) Includes the information required by paragraph (c)(4)(ii) of this section.

(ii) *Information included in an appraisal summary.* An appraisal summary shall include the following information:

(A) Name and taxpayer identification number of the donor (Social Security number if the donor is an individual or employer identification number if the donor is a closely held corporation, personal service corporation, partnership or S corporation);

(B) A description of the property in

sufficient detail for a person who is not generally familiar with the type of property to ascertain that the property that was appraised is the property that was contributed;

(C) In the case of tangible property, a brief summary of the overall physical condition of the property at the time of the contribution;

(D) The manner of acquisition (e.g., purchase, exchange, gift, or bequest) and the date of acquisition of the property by the donor, or if the property was created, produced, or manufactured by or for the donor, a statement to that effect and the approximate date the property was substantially completed;

(E) The cost or other basis of the property adjusted as provided by section 1016;

(F) The name, address, and taxpayer identification number of the donee;

(G) The date the donee received the property;

(H) The name, address, and taxpayer identification number of the qualified appraiser (or appraisers) who signs the appraisal summary and of other persons as required by paragraph (c)(3)(ii)(E) of this section;

(I) The appraised fair market value of the property on the date of contribution;

(J) The declaration by the appraiser described in paragraph (c)(5)(i) of this section;

(K) A declaration by the appraiser stating that—

(1) The fee charged for the appraisal is not of a type prohibited by paragraph (c)(6) of this section; and

(2) Appraisals prepared by the appraiser are not being disregarded pursuant to 31 U.S.C., 330(c) on the date the appraisal summary is signed by the appraiser; and

(L) Such other information as may be specified by the form or its instructions.

(iii) *Signature of the donee.*—The person who signs the appraisal summary for the donee shall be an official authorized to sign the tax or information returns of the donee, or a person specifically authorized to sign appraisal summaries by an official authorized to sign the tax or information return of the donee. The signature of the donee does not represent concurrence in the appraised value of the contributed property. Rather, it represents acknowledgment of receipt of the property described in the appraisal summary on the date specified in the appraisal summary and that the donee understands the information reporting requirements imposed by section 6050L and 6050L-1T. In general, section 6050L requires the donee to file an information return with the Internal Revenue Service in the event the donee sells, exchanges or otherwise disposes of the property (or any portion thereof) described in the appraisal summary within 2 years after the date of receipt of the property.

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(iv) *Special rules.*—(A) *Contents of appraisal summary required in the case of certain contributions of nonpublicly traded stock.* With regard to nonpublicly traded stock described in paragraph (c)(2)(ii) of this section, the term "appraisal summary" means a document that complies with the requirements of paragraph (c)(4)(i)(A) and (B) of this section and includes the claimed or reported fair market value of the stock and the information required by paragraph (c)(4)(ii)(A), (B), and (D) through (G) of this section.

(B) *Number of appraisal summaries.*—A separate appraisal summary for each item of property described in paragraph (c)(1) must be attached to the donor's return. If during the donor's taxable year, the donor contributes similar items of property described in paragraph (c)(1) of this section to more than one donee, the donor shall attach to the donor's return a separate appraisal summary for each donee. If, however, during the donor's taxable year, a donor contributes similar items of property described in paragraph (c)(1) of this section to the same donee, the donor may attach to the donor's return a single appraisal summary with respect to all similar items of property contributed to the same donee. Such an appraisal summary shall provide all the information required by paragraph (c)(4)(ii) of this section for each

18 item of property, except that the appraiser may select any items whose aggregate value is appraised at $100 or less for which a group description will suffice. See paragraph (c)(7)(iii) of this section for the definition of similar items of property.

(C) *Manner of acquisition and cost basis information.* If a taxpayer has reasonable cause for being unable to provide the information required by paragraph (c)(4)(ii)(D) and (E) of this section, an appropriate explanation should be attached to the appraisal summary. The taxpayer's deduction will not be disallowed simply because of the inability (for reasonable cause) to provide these items of information.

(D) *Information excluded from certain appraisal summaries*—The information required by paragraph (c)(4)(ii)(D),(E) and (H) through (L) of this section does not have to be included on the appraisal summary at the time it is signed by the donee.

(E) *Appraisal summary required to be provided to partners and shareholders.* If the donor is a partnership or S corporation, the donor shall provide a copy of the appraisal summary to every partner or shareholder, respectively, who receives an allocation of a charitable contribution deduction under section 170 with respect to the property described in the appraisal summary.

(F) *Partners and S corporation shareholders.* A partner of a partnership or shareholder of an S corporation who receives an allocation of a deduction under section 170 for a charitable contribution of property to which this paragraph (c) applies must attach a copy of the partnership's or S corporation's appraisal summary to the tax return on which the deduction for the contribution is first claimed. If such appraisal summary is not attached, the partner's or shareholder's deduction shall not be allowed except as provided for in paragraph (c)(4)(iv)(C) of this section.

(G) *Failure to attach appraisal summary.* In the event that a donor fails to attach to the donor's return an appraisal summary as required by paragraph (c)(2)(i)(B) or (ii)(A) of this section, the Internal Revenue Service may request that the donor submit the appraisal summary within 90 days of the request. If such a request is made and the donor complies with the request within the 90-day period, the deduction under section 170 shall not be disallowed for failure to attach the appraisal summary, provided that the donor's failure to attach the appraisal summary was a good faith omission.

(5) *Qualified appraiser*—(i)*In general.* The term "qualified appraiser" means an individual (other than a person described in paragraph (c)(5)(iv) of this section), who includes on the appraisal summary (described in paragraph (c)(4) of this section), a declaration that—

(A) The individual holds himself or herself out to the public as an appraiser;

(B) Because of the appraiser's qualifications as described in the appraisal (pursuant to paragraph (c)(3)(ii)(F)), the appraiser is qualified to make appraisals of the type of property being valued;

(C) The appraiser is not one of the persons described in paragraph (c)(5)(iv) of this section; and

(D) The appraiser understands that a false or fraudulent overstatement of the value of the property described in the qualified appraisal or appraisal summary may subject the appraiser to a civil penalty under section 6701 for aiding and abetting an understatement of tax liability, and consequently the appraiser may have appraisals disregarded pursuant to 31 U.S.C. 330(c) (see paragraph (c)(3)(iii) of this section).

(ii) *Exception.* An individual is not a qualified appraiser with respect to a particular donation, even if the declaration specified in paragraph (c)(5)(i) of this section is provided in the appraisal summary, if the donor had knowledge of facts which would cause a reasonable person to expect the appraiser falsely to overstate the value of the donated property (e.g., where an agreement is made between the donor and the appraiser concerning the amount at which the property would be valued and such amount exceeds the fair market value

of the property).

(iii) *Numbers of appraisers.* More than one appraiser may appraise the donated property, provided that each appraiser complies with the requirements of this paragraph (c), including signing the qualified appraisal and appraisal summary as required by paragraph (c)(3)(i)(B) and (4)(i)(B) of this section, respectively.

(iv) *Qualified appraiser exclusions.* The following persons cannot be qualified appraisers with respect to particular property:

(A) The donor or the taxpayer who claims or reports a deduction under section 170 for the contribution of the property that is being appraised.

(B) A party to the transaction in which the donor acquired the property being appraised (*i.e.* the person who sold, exchanged, or gave the property to the donor, or any person who acted as an agent for the transferor or for the donor with respect to such sale, exchange, or gift), unless the property is donated within 2 months of the date of acquisition and its appraised value does not exceed its acquisition price.

(C) The donee of the property.

(D) Any person employed by any of the foregoing persons or related to any of the foregoing persons under section 267(b) (*e.g.*, if the donor acquired a painting from an art dealer, neither the art dealer nor persons employed by the dealer can be qualified appraisers with respect to that painting).

(E) Any person whose relationship to any of the persons listed in paragraph (c)(5)(iv)(A) through (D) of this section would cause a reasonable person to question the independence of such appraiser. For example, an appraiser who is regularly used by any person described in paragraph (c)(5)(iv)(A),(B), or (C) of this section and who does not perform a substantial number of appraisals for other persons has a relationship to such person that is similar to that of an employee and cannot be a qualified appraiser with respect to the property contributed.

(6) *Appraisal fees.*—(i) *In general.* Except as otherwise provided in paragraph (c)(6)(ii) of this section, no part of the fee arrangement for a qualified appraisal can be based, in effect, on a percentage (or set of percentages) of the appraised value of the property. If a fee arrangement for an appraisal is based in whole or in part on the amount of the appraised value of the property, if any, that is allowed as a deduction under section 170, after Internal Revenue Service examination or otherwise, it shall be treated as a fee based on a percentage of the appraised value of the property. For example, an appraiser's fee that is subject to reduction by the same percentage as the appraised value may be reduced by the Internal Revenue Service would be treated as a fee that violates this paragraph (c)(6).

(ii) *Exception.* Paragraph (c)(6)(i) of this section does not apply to a fee paid to a generally recognized association that regulates appraisers provided all of the following requirements are met:

(A) The association is not organized for profit and no part of the net earnings of the association inures to the benefit of any private shareholder or individual (these terms have the same meaning as in section 501(c)), and

(B) The appraiser does not receive any compensation from the association or any other persons for making the appraisal, and

(C) The fee arrangement is not based in whole or in part on the amount of the appraised value of the donated property, if any, that is allowed as a deduction under section 170 after Internal Revenue Service examination or otherwise.

(7) *Meaning of terms.* For purposes of this section —

(i) *Closely held corporation.* The term "closely held corporation" means any corporation (other than an S corporation) with respect to which the stock ownership requirement of paragraph (2) of section 542(a) of the Code is met.

(ii) *Personal service corporation.* The term "personal service corporation" means any corporation (other than an S corporation) which is a Service organization (within the

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20 meaning of section 414(m)(3) of the Code).

(iii) *Similar items of property.* The phrase "similar items of property" means property of the same generic category or type, such as stamps, coins, lithographs, paintings, photographs, books, nonpublicly traded stock, publicly traded stock, land, or buildings. For example, if a donor claims on her return for the year deductions of $2,000 for books given by her to College A, $2,500 for books given by her to College B, and $900 for books given by her to College C, the $5,000 threshold of paragraph (c)(1) of this section is exceeded. Therefore, the donor must obtain a qualified appraisal for the books and attach to her return three appraisal summaries for the books donated to A, B, and C. For rules regarding the number of qualified appraisals and appraisal summaries required when similar items of property are contributed, see paragraph (C) (3)(iii)(A) and (4)(iv)(B), respectively, of this section.

(iv) *Publicly traded securities.* The term "publicly traded securities" means securities (within the meaning of section 165(g)(2) of the Code) for which (as of the date of the contribution) market quotations are readily available on an established securities market. For purposes of this section, market quotations are readily available on an established securities market if a security is:

(A) Listed on the New York Stock Exchange, the American Stock Exchange, or any city or regional exchange in which quotations are published on a daily basis, including foreign securities listed on a recognized foreign, national, or regional exchange; or

(B) Regularly traded in the national or regional over-the-counter market, for which published quotations are available.

(v) *Nonpublicly traded securities.* The term "nonpublicly traded securities" means securities (within the meaning of section 165(g)(2) of the Code) which are not publicly traded securities as defined in paragraph (c)(7)(iv) of this section.

(vi) *Nonpublicly traded stock.* The term "nonpublicly traded stock" means any stock of a corporation (evidence by a stock certificate) which is not a publicly traded security. The term stock does not include a debenture or any other evidence of indebtedness.

Par. 3. A new 1.6050L-1T is added immediately after 1.6050J-1T to read as follows:

§1.6050L-1T Temporary regulations; information return by donees relating to certain dispositions of donated property (temporary).

(a) *In general.* If the donee of any charitable deduction property (as defined in paragraph (d) of this section) sells, exchanges, or otherwise disposes of such property (or any portion thereof) within 2 years after the date of the contribution of such property, the donee shall make an information return on the form prescribed by the Internal Revenue Service.

(b) *Information required to be provided on return.* The information return required by paragraph (a) of this section shall include the following:

(1) The name, address, and employer identification number of the donee;

(2) The name, address and taxpayer identification number of the donor (social security number if the donor is an individual or employer identification number if the donor is a closely held corporation, personal service corporation, partnership, or S corporation);

(3) A description of the property (or portion disposed of) in sufficient detail to identify the charitable deduction property;

(4) The date of the contribution;

(5) The amount received on the disposition;

(6) The date of the disposition; and

(7) Any other information as may be specified by the form or its instructions.

(c) *Statement to be furnished to donors.* Every donee making a return under section 6050L and this section with respect to the disposition of charitable deduction property contributed to the donee shall furnish a copy of the return to the donor of the property.

Related Regulations

(d) *Charitable deduction property.* For purposes of this section, the term "charitable deduction property" means any property (other than money or publicly traded securities as defined in paragraph (c)(7)(iv) of 1.170A-13T) contributed after December 31, 1984, with respect to which a donee signs an appraisal summary (as required by paragraph (c)(4)(ii)(B) or (iv)(A) of 1.170A-13T).

(e) *Retention of appraisal summary.* The donee shall retain the appraisal summary described in paragraph (c)(4) of 1.170A-13T in the donee's records for so long as it may be relevant in the administration of any internal revenue law.

(f) *Place and time for filing information returns.*—(1) *Place for filing.* The donee information return required by section 6050L and this section shall be filed with the internal revenue service center listed on the return form or its instructions.

(2) *Time for filing.* The donee information return shall be filed on or before the 90th day after the donee sells, exchanges or otherwise disposes of the charitable deduction property (as described in paragraph (d) of this section).

(g) *Penalties.* For penalties for failure to comply with the requirements of this section, see sections 6652, 6676 and 6678.

(Approved by the Office of Management and Budget under Control Number 1545-0908)

26 CFR Part 1

[T.D. 8002]

Income Tax; Taxable Years Beginning After December 31, 1953; Substantiation of Charitable Contributions

Agency: Internal Revenue Service, Treasury

Action: Final regulations

Published in the *Federal Register*, Vol. 49, No. 252, December 31, 1984 (pp. 50663-50667)

31 CFR Part 10

Regulations Governing the Discipline of Appraisers Against Whom Aiding and Abetting Penalties Under the Internal Revenue Code Have Been Assessed

Agency: Department of the Treasury

Action: Notice of proposed rulemaking

Published in the *Federal Register*, Vol. 50, No. 34, February 20, 1985 (pp. 7075-7078)

From Public Law 98-369:

PART III—OTHER COMPLIANCE PROVISIONS 21

SEC. 155. Substantiation of Charitable Contributions; Modifications of Incorrect Valuation Penalty.

(a) *Substantiation of Contributions of Property.*—(1) *In General.*—Not later than December 31, 1984, the Secretary shall prescribe regulations under section 170(a)(1) of the Internal Revenue Code of 1954, which require any individual, closely held corporation, or personal service corporation claiming a deduction under section 170 of such Code for a contribution described in paragraph (2)—

(A) to obtain a qualified appraisal for the property contributed,

(B) to attach an appraisal summary to the return on which such deduction is first claimed for such contribution, and

(C) to include on such return such additional information (including the cost basis and acquisition date of the contributed property) as the Secretary may prescribe in such regulations.

Such regulations shall require the taxpayer to retain any qualified appraisal.

(2) *Contributions to which paragraph (1) applies.*—For purposes of paragraph (1), a contribution is described in this paragraph—

"(A) if such contribution is of prop-

22 erty (other than publicly traded securities), and

"(B) if the claimed value of such property (plus the claimed value of all similar items of property donated to 1 or more donees) exceeds $5,000.

In the case of any property which is nonpublicly traded stock, subparagraph (B) shall be applied by substituting "$10,000" for "$5,000".

"(3) *Appraisal summary.*—For purposes of this subsection, the appraisal summary shall be in such form and include such information as the Secretary prescribes by regulations. Such summary shall be signed by the qualified appraiser preparing the qualified appraisal and shall contain the TIN of such appraiser. Such summary shall be acknowledged by the donee of the property appraised in such manner as the Secretary prescribes in such regulations.

"(4) *Qualified appraisal.*—The term "qualified appraisal" means an appraisal prepared by a qualified appraiser which includes—

"(A) a description of the property appraised,

"(B) the fair market value of such property on the date of contribution and the specific basis for the valuation,

"(C) a statement that such appraisal was prepared for income tax purposes,

"(D) the qualifications of the qualified appraiser,

"(E) the signature and TIN of such appraiser, and

"(F) such additional information as the Secretary prescribes in such regulations.

"(5) *Qualified appraiser.*

"(A) *In general.*—For purposes of this subsection, the term "qualified appraiser" means an appraiser qualified to make appraisals of the type of property donated, who is not—

"(i) the taxpayer,

"(ii) a party to the transaction in which the taxpayer acquired the property,

"(iii) the donee,

"(iv) any person employed by any of the foregoing persons or related to any of the foregoing persons under section 267(b) of the Internal Revenue Code of 1954, or

"(v) to the extent provided in such regulations, any person whose relationship to the taxpayer would cause a reasonable person to question the independence of such appraiser.

"(B) *Appraisal fees.*—For purpose of this subsection, an appraisal shall not be treated as a qualified appraisal if all or part of the fee paid for such appraisal is based on a percentage of the appraised value of the property. The preceding sentence shall not apply to fees based on a sliding scale that are paid to a generally recognized association regulating appraisers.

"(6) *Other definitions.*—For purposes of this subsection—

(A) *Closely held corporation.*—The term "closely held corporation" means any corporation (other than an S corporation) with respect to which the stock ownership requirement of paragraph (2) of section 542(a) of such Code is met.

(B) *Personal service corporation.*—The term "personal service corporation" means any corporation (other than an S corporation) which is a service organization (within the meaning of section 414(m)(3) of such Code).

(C) *Publicly traded securities.*—The term "publicly traded securities" means securities for which (as of the date of the contribution) market quotations are readily available on an established securities market.

(D) *Nonpublicly traded stock.*—The term "nonpublicly traded stock" means any stock of a corporation which is not a publicly traded security.

(E) *The Secretary.*—The term "Secretary" means the Secretary of the Treasury or his delegate.

(b) *Information report required on disposition by donee.*—(1) *In General.*—Subpart B of part III of subchapter A of chapter 61 (relating to information and returns) is amended by adding at the end thereof the following new section:

"SEC. 6050I. Returns Relating to Certain Dispositions of Donated Property.

"(a) *General rule.*—If the donee of any charitable deduction property sells, exchanges, or otherwise disposes of such property within 2 years after its receipt, the donee shall make a return (in accordance with forms and regulations prescribed by the Secretary showing)—

"(1) the name, address, and TIN of the donor,

"(2) a description of the property,

"(3) the date of the contribution,

"(4) the amount received on the disposition, and

"(5) the date of such disposition.

"(b) *Charitable deduction property.*—For purposes of this section, the term 'charitable deduction property' means any property (other than publicly traded securities) contributed in a contribution for which a deduction was claimed under section 170 if the claimed value of such property (plus the claimed value of all similar items of property donated by the donor to 1 or more donees) exceeds $5,000.

"(c) *Statement to be furnished to donors.*—Every person making a return under subsection (a) shall furnish a copy of such return to the donor at such time and in such manner as the Secretary may by regulations prescribe.

"(d) *Definition of publicly traded securities.*—The term 'publicly traded securities' means securities for which (as of the date of the contribution) market quotations are readily available on an established securities market."

(2) *Penalties.*—

(A) Subparagraph (B) of section 6652(a)(1) (relating to failure to file certain information returns, etc.) is amended—

(i) by striking out "or" at the end of clause (vii),

(ii) By adding "or" at the end of clause (viii), and

(iii) by inserting after clause (viii) the following new clause:

"(ix) section 6050L (relating to returns relating to certain dispositions of donated property),"

(B) Paragraph (1) of section 6678(a) (relating to failure to furnish certain statements is amended—

(i) by striking out "or 6050K(b)" and inserting in lieu thereof "6050K(b), or 6050L(c)", and

(ii) by striking out "or 6050K(a) and inserting in lieu thereof "6050K(a), or 6050L(a)".

(3) *Clerical amendment.*—The table of sections of subpart B of part III of subchapter A of chapter 61 is amended by adding at the end thereof the following new item:

"Sec. 6050L. Returns relating to certain dispositions of donated property."

(c) *Modifications of Incorrect Valuation Penalty.*—(1) *Modifications Of Section 6659.*-

(A) *Elimination of requirement that property be acquired within the last 5 years.*—Subsection (c) of section 6659 is amended to read as follows:

"(c) *Valuation overstatement defined.*—For purposes of this section, there is a valuation overstatement if the value of any property, or the adjusted basis on any property, claimed on any return is 150 percent or more of the amount determined to be the correct amount of such valuation or adjusted basis (as the case may be)."

(B) *Special rules for overstatement of charitable deduction.*—Section 6659 is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) *Special rules for overstatement of charitable deduction.*

"(1) *Amount of applicable percentage.*—In the case of any underpayment attributable to a valuation overstatement with respect to charitable deduction property, the applicable percentage for purposes of subsection (a) shall be 30 percent.

"(2) *Limitation on authority to waive.*—In the case of any underpayment attributable to a valuation overstatement with respect to charitable deduction property, the Secretary may not waive any portion of the addition to tax provided by this section unless the Secretary determines that

"(A) the claimed value of the property was based on a qualified appraisal made by a qualified appraiser, and

"(B) in addition to obtaining such appraisal, the taxpayer made a good

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24 faith investigation of the value of the contributed property.

"(3) *Definitions.*—For purposes of this subsection— "(A) *Charitable deduction property.*—The term 'charitable deduction property' means any property contributed by the taxpayer in a contribution for which a deduction was claimed under section 170. For purposes of paragraph (2), such term shall not include any securities for which (as of the date of the contribution) market quotations are readily available on an established securities market.

"(B) *Qualified appraiser.*—The term 'qualified appraiser' means any appraiser meeting the requirements of the regulations prescribed under section 170(a)(1).

"(C) *Qualified appraisal.*—The term 'qualified appraisal' means any appraisal meeting the requirements of the regulation's prescribed under section 170(a)(1)."

(2) *Extension of incorrect valuation penalty to estate and gift tax.*—(A) Subchapter A of chapter 68 (relating to additions to the tax and additional amounts) is amended by inserting after section 6659 the following new section:

"SEC. 6660. Addition to Tax in the Case of Valuation Understatement for Purposes of the Estate or Gift Taxes.

"(a) *Addition to the tax.*—In the case of any underpayment of a tax imposed by subtitle B (relating to estate and gift taxes) which is attributable to a valuation understatement, there shall be added to the tax an amount equal to the applicable percentage of the underpayment so attributed.

"(b) *Applicable percentage.*—For purposes of subsection (a), the applicable percentage shall be determined under the following table:

"If the valuation claimed is the following percent of the correct valuation—	**The applicable percentage is:**
50 percent or more but not more than 66⅔ percent	10
40 percent or more but less than 50 percent	20
Less than 40 percent	30

"(c) *Valuation understatement defined.*—For purposes of this section, there is a valuation understatement if the value of any property claimed on any return is 66⅔ percent or less of the amount determined to be the correct amount of such valuation.

"(d) *Underpayment Must Be At Least $1,000.*—This section shall not apply if the underpayment is less than $1,000 for any taxable period (or, in the case of the tax imposed by chapter 11, with respect to the estate of the decedent).

"(e) *Authority to waive.*—The Secretary may waive all or any part of the addition to the tax provided by this section on a showing by the taxpayer that there was a reasonable basis for the valuation claimed on the return and that such claim was made in good faith."

(B) *Clerical amendment.*—The table of sections for subchapter A of chapter 68 is amended by inserting after the item relating to section 6659 the following new item:

"SEC. 6660 Addition to tax in the case of valuation understatement for purposes of estate or gift taxes."

(d) *Effective dates.*—

(1) *Subsections (a) and (b).*—The amendments made by subsections (a) and (b) shall apply to contributions made after December 31, 1984, in taxable years ending after such date.

Required Forms

Form 8282 Donee Information Return

Form 8283 Noncash Charitable Contributions Appraisal Summary

These forms are available from local Internal Revenue Service offices. Form 8283 is a required attachment at the time donors file their tax returns. Form 8282 is used by museums only when property that falls under the requirements of the law is sold, exchanged or otherwise disposed of. Photoreproductions of the forms are acceptable for submission to the IRS.

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SUBMISSIONS FOR THE RECORD

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COMMENTS FOR THE TRANSCRIPT
OF THE HOUSE WAYS & MEANS COMMITTEE HEARING
ON THE IRS ART ADVISORY PANEL

Founded in 1949, the Appraisers Association of America represents 1200 appraisers in approximately 250 different areas of specialization, most of whom are in the field of personal property.

Under the tax legislation of 1984, appraisers submitting reports to the U.S. government are subject to severe penalties and punitive action should their appraisals be deemed "fraudulent". The IRS, in reviewing those appraisals found to be at odds with the government's viewpoint, is asked to make a "good or bad faith" judgement, and this, in turn, will aid the Director of Practice in deciding what, if any, action should be taken against an individual appraiser. In determining the accuracy and integrity of a particular appraisal, the IRS relies heavily on the recommendation of its Art Advisory Panel whose members routinely review appraisals of objects, in many different categories, which are claimed to be worth more than $20,000.

Consequently, the Appraisers Association of America is most concerned that the composition and structure of the Art Advisory Panel be such as to insure that any appraiser, whose work is being scrutinized, will be guaranteed proper peer review. Unfortunately, we believe that at present, for the following reasons, this is not the case.

As we understand it, the Art Advisory Panel consists of five full-time appraisers who are employed by the federal government, members of the museum community and a group of dealers, over 95% of whom have been traditionally recruited from the Art Dealers Association of America (ADAA).

One may question the preparation of the government appraisers whose knowledge is more theoretical than practical, having been garnered from course study rather than from work in the field of appraising. By the same token, the knowledge of prices on the part of museum officials may also be questioned since the American Association of Museums, whose rules govern practically every museum employee, forbids any of its members from giving a value judgement for any work of art. The objectivity of members of the ADAA may also be called into question for reasons to be given below.

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The most curious aspect of the composition of the Art Advisory Panel, however, is that the category of independent appraisers is not at all represented because the current rules of the panel require all panelists to give up appraising during their two year tenure on the panel. Since panelists are not compensated for their service, only the most altruistic and affluent independent appraiser could possibly consider serving. Such an individual has yet to be found.

Several justifications have been offered for this strange regulation. First, the government believes that an appraiser who practices his profession while serving on the panel may have a conflict of interest -- presumably because he may review an appraisal he has recently done. However, the IRS also admits that it usually takes a minimum of three years for an appraisal to meander through the government's bureaucracy to the panel. Consequently, a mere arithmetic analysis of this argument would render it invalid.

Second, it is feared by the Treasury that a panelist who practices appraising while on the panel may turn this fact, in his public relations, to an unfair commercial advantage. However, the Treasury could easily establish a rule outlawing such publicity without eliminating the appraiser's participation. In point of fact, the ADAA, since 1968, in soliciting business for its appraisal service, has publicly boasted of the role its members play on the panel. In light of this, the Treasury's other argument would appear to be meaningless.

Countering these dubious arguments, there is significant reason for the inclusion of independent appraisers on the Art Advisory Panel; primarily, to keep the panel free from the very conflict of interest the IRS hopes to preserve by excluding them.

Objects presented to panel members for review are extrapolated from their appraisals and reviewed as free-floating entities arranged in alphabetical order by the name of the artist. Presumably, the panel considers this to be an objective system with adequate controls. Unfortunately, we cannot agree since works of art do not subscribe to any uniformity of categorization. They speak for themselves. The hypothetical $5 million Picasso is unique; such an object or similar objects would have a provenance and history known to all immersed in the art world. If, in our hypothetical case, an individual panelist, recruited from the ADAA, did not contribute to the actual appraisal before the panel, it is almost a given certainty that he would know upon review if his organization was responsible for the appraisal, and this, in turn, may lead to a prejudicial inclination on his part to defend the value stated in the appraisal.

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By the same token, a museum official may easily know the identity of the donor of the Picasso in question and may not want to see the appraised value reduced for fear of discouraging future donations from the same individual.

Such a scenario represents true conflict of interest fraught with collusion. Only the independent appraiser, in such an instance, could be considered free of any conflict of interest since he is accountable to no one but himself. Yet, paradoxically, under the current rules governing the panel, he is virtually prohibited from serving since he would be deprived, during his tenure on the panel, of the income from his profession which guarantees his independence.

Therefore, it is our belief that, while the establishment of the Art Advisory Panel has, in theory, introduced a broadened base of knowledge and an increased objectivity in the government's review of appraisals, the panel's objectivity cannot be guaranteed until some provision has been made to allow the independent appraiser to participate in its deliberations. Until that time, the panel's conclusions will always be tainted by the very conflict of interest and self-serving aspects the government sought to avoid through its establishment.

The Appraisers Association of America would welcome an opportunity of collaborating with the IRS and Treasury in refining the composition and structure of the Art Advisory Panel.

Victor Wiener
Executive Director

Statement Submitted to the House Ways and Means Oversight Subcommittee Regarding the IRS Art Advisory Panel

By

Kathleen M. Burns, former investigator
House Government Activities and Transportation Subcommittee

Mr. Chairman and Members of the Subcommittee:

Thank you for this opportunity to submit my remarks for the hearing record of June 3, 1986. I was out of the country and not able to attend the proceedings.

By way of introduction, let me explain my interest in the appraisal reform process in general and the IRS Art Advisory Panel in particular.

For the past three years, I served as an investigator with the House Government Activities and Transportation Subcommittee, which is chaired by Rep. Cardiss Collins, D-Ill. Our subcommittee was responsible for launching an intensive investigation into the problems of fraudulent appraisals and donations for charitable purposes, which culminated in hearings, extensive correspondence and finally, the preliminary regulations which went into effect on Dec. 31, 1984. Because of my intimate exposure and involvement in this area on behalf of the subcommittee, I was invited by Vanessa Clark, who serves as an attorney on the Ways and Means staff, to submit some remarks.

Let me emphasize that I speak only for myself and not for the subcommittee since I have left the staff in order to prepare to join the journalism faculty at American University in Washington, D.C. Prior to joining the Hill staff, I had spent 15 years in investigative reporting for a variety of publications(i.e. Chicago Tribune, UPI, Fairchild Publicatio which is now Capitol Cities, as well as numerous magazine and newspaper articles.)

BACKGROUND

During March 1983, the Washington Post ran a six-part series by Ted Gupp, a reporter who is also an attorney, based on his investigation of overvalued gems and minerals for donation to the Smithsonian Institution. A major part of the series focused on Paul DeSautels, then the Smithsonian mineral and gem curator, who was later to announce early retirement because of revelations about various questionable practices.

In April, I joined the subcommittee, which Mrs. Collins had been asked to chair earlier that year. Because the Smithsonian came under the agencies assigned by the Government Operations Committee to her subcommittee, she asked me to review the information and to decide what action, if any, should be taken.

On Aug. 4, 1983, the subcommittee held a lengthy hearing on appraisal problems. It readily became apparent that the problem was not limited to gems and minerals nor was the Smithsonian the only museum having difficulties in this regard. This hearing served as a springboard for future correspondence and legislation.

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In February 1984, Mrs. Collins sent similar letters(which I had drafted) to Rep. Daniel Rostenkowski, D-Ill, chairman of the House Ways and Means Committee, and to Sen. Robert Dole, R-Kansas, chairman of the Senate Finance Committee, offering specific suggestions on including appraisal reform as part of the overall Tax Reform of 1984. The first such draft of the reform was published on June 22, 1984, and called for formal and temporary regulations by the end of the year. These regulations were issued on Dec. 31, 1984, with the mandatory 60-day comment period. The draft called for an appraisal by a "qualified appraiser" but left such qualifications in doubt. The Government Activities Subcommittee was instrumental in arranging a public hearing in conjunction with the IRS and the Treasury on June 28, 1985 to discuss this inconsistency and other apparent problems with the proposed legislation.

The Government Activities Subcommittee was also instrumental in publishing the overvaluation and undervaluation information from the IRS Art Advisory Panel, which has not been widely distributed,with the statistical breakdown that was subsequently added by Ms. Karen Carolan and her staff, based on a subcommittee request.

Let me briefly enumerate some of the problems I saw during my three years of work on appraisal reform.

THE ROLE OF APPRAISERS

Contrary to an opinion held by some members of the Ways and Means Oversight Subcommittee, you cannot discuss the status of the IRS Art Advisory Process apart from appraisers and appraisals since the main issue this panel deals with is whether they will accept or reject this appraisal. However, no appraisers or appraisal organizations were present at the June 3, 1986 hearing(as witnesses.)

In the past, the Government Activities Subcommittee has commented in writing about the conspicuous lack of independent appraisers -- totally apart from art dealers -- as members of this panel. I realize that a member of the Soetheby's staff subsequently served, but the numbers are still too low.

Under current restrictions, independent appraisers are barred from serving on the Panel while still actively practicing. However, no such impediment seems to apply to the numerous members of the Art Dealers Association of America who also render outside professional opinions while serving on this Panel and they also include such membership on the IRS Panel as part of their advertisements for their services.

Independent appraisers should be able to serve on panels since these review meetings generally occur 3 to 4 years after an appraisal has been submitted as part of one's taxes. The IRS Panel often meets only 2 to 3 times a year, depending on the area(oriental paintings, sculpture, African art etc.) For difficult cases, a specialist in this field could serve on the panel for a one-time basis, so the IRS would have the benefit of this person's expertise.

In the future, I would urge that <u>all</u> persons who serve on these confidential IRS panels be prohibited from advertising that they currently serve on this panel and from implying that their opinions are automatically accepted by the IRS in tax matters because of this work.

The panels could use the services of large auction houses such as Soetheby's and Christie's on an "as needed" basis to supplement the IRS information on actual market conditions affecting past and current value and authenticity of artifacts reviewed by the Panel.

Our subcommittee received various complaints on a regular basis that some of IRS' own appraisers <u>in the field</u> did not appear to be fully qualified for the assessment work they were doing in the art and artifacts area, with an overdependency on those who were trained primarily in real estate valuations. Leslie Shapiro, IRS Director of Practice, told us he also had received some complaints. Since this is a confidential matter, I would be happy to refer specific information to your committee rather than reveal information here in the public record.

The IRS is to be commended for its expansion of its advisory panel from 12 to 25 members but there is still an overwhelming need for in-house IRS staff to review questionable appraisals at the regional and national level for photographs, stamps, books, coins, lithographs and minerals. In the area of gems and minerals, the IRS has relied extensively

on Rick Nixon of the IRS Atlanta office, who subcontracted out work with blanket purchase orders primarily to three appraisers. One of these, from New York City, listed the IRS as his primary client(Transcript from IRS vs. Dr. Dale Dubin, p. 417), noting that he had performed 33 appraisals thus far for the IRS during approximately 3 years, with some fees ranging from $6,000 to $10,000.

The Government Activities Subcommittee had questioned the IRS as to why it was not possible to increase its own in-house expertise in this area, and cost was cited as the primary factor. However, the IRS' own documents note that this outside appraiser had received $90,000 from the IRS for appraisals done over a limited period of time.

ADVERSARIAL ROLE OF THE IRS

Since the tax code was amended in 1917, charitable gifts of tangible property to tax-exempt organizations have been considered a legitimate donation. Charitable contributions for the arts are similar to tax breaks that are designed to foster socially useful purposes. This would include IRA's for our old age; energy credits for our homes; and mortgages which allow us to deduct interest payments from our taxes.

As a result of the Smithsonian gem scandal, the New York print scam and other such attempts, it appears that some IRS officials have begun to consider all such donations as fraudulent. For example, in past months, the IRS reviewed all gifts of gems and minerals to the Smithsonian for a three-year period and audited all donors, including some who did not even take a tax deduction.

The burden of proof for documenting value is rightly on the owner/donor who must rely on what he or she thinks is a reputable appraiser, but since the current standard is not clear(the Dec. 31, 1984 proposed regulations have not been finalized nor has the lack of an adequate definition on what constitutes a "qualified"appraiser been remedied), there is an inherent risk in giving any gift --- and thus one is open to tremendous liability, as noted by Michael Grogan who heads Sotheby's Appraisal Co. in New York City(212-606-7440) during conversations with the GAT staff.

The relationship between the IRS staff and the IRS Art Advisory Panel to donors and appraisers need not automatically be an adversarial one. In Atlanta, Rick Nixon has stated that donations generally are evaluated(i.e. gems and minerals) primarily on a cost basis, regardless of when an item was purchased, the degree of rarity in the market place, degree of demand, normal appreciation and the state of the art of appraisal techniques when the appraisal was made --- not when it was reviewed by the IRS. Moreover, since some art and artifact items are sold below cost at an auction, comparable cost alone is not always a realistic indicator of value.

Philanthrophy is and must remain an important concept in the American culture. Without the generosity of various donors, our museum walls would remain bare. Few of us would ever see the world's great art treasures if they were all kept in private homes.

President Reagan has particularly called on the private sector to be generous in its donations to public and cultural causes. While the government needs to be specific in its guidelines for such gifts and uniform in their enforcement, it need not resort to the French system of justice whereby all donors are guilty until proven innocent.

Let the IRS and the IRS Art Advisory Panel strongly admonish those appraisers and donors who break the law, without creating a police state mentality.

One such avenue for this process is through the Director of Practice Office of the IRS. Under its jurisdiction, accountants, attorneys, certified public accountants and actuaries can be barred from practicing before the IRS if fraudulent activity can be documented. Hopefully, the appraisers will also come under this jurisdiction. It would seem reasonable to have the IRS Advisory Panel staff notify the IRS Director of Practice Office when there appears to be a significant question regarding either overvaluation or undervaluation in an item the Panel is examining.

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In spite of all the publicity, overvaluation and undervaluation of donations reviewed by the Panel in the past two years, there is no noticeable drop in the problem, based on figures released earlier in 1986, with definite upswings in some cases.

It may be helpful to review Title 31 of the tax code and to suggest some amendments in the wording regarding the disciplining of appraisers. One concept may be to give to the Secretary of the Treasury the same sanctions that Section 156(of the Dec. 31, 1984 draft regulations) does in those instances where an appraiser has to provide an appraisal which the appraiser knows or has reason to know will be used in connection with a Treasury Department matter.

Such authority would permit the Treasury to take action in cases where the language was false, misleading, reckless, grossly incompetent or reflected a failure to exercise due diligence.

The statute needs to note the difference in penalities between an individual who fails to exercise due diligence and someone who is wilfully fraudulent.

Under the directives of the Conference Report98-861 for the Deficit Reduction Act of 1984, the conferees stipulate how penalties applying to lawyers, accountants and actuaries can be applied in a suitable way to appraisers(p. 999). The document also notes that: "The conferees expect that in developing substantiation of regulations, the Treasury will consult, to the extent practicable, with charitable organizations, appraisers and appraisal organizations, and others."(p.996)

Such a cooperative effort is warranted to produce the best results.

TAX COURT AND THE IRS ART ADVISORY PANEL

When the IRS Art Advisory Panel questions an appraisal submitted for tax purposes, the arena for arguing the case becomes the tax court. Unlike other parts of our judicial system, which employ the "due process" concept of trial by one's peers, tax court is governed by administrative laws. I understand that the "hearsay exception" rule is also applicable so that rumor can be considered as evidence.

When the IRS Art Advisory Panel refers a case to the courts, the main problem is that appraisals are not an exact science, like mathematics. There is room for reasonable people to disagree, but the proper forum for such debates is not the volatile environment of tax court.

The IRS enters such contests with a weighted deck since it relies on staff attorneys. The defendant, on the other hand, incurs costly legal fees of $100 to $200an hour, with a minimum of 10 days to get ready for a trial, plus the cost of expert witness fees. There are no costs (of significance) to the IRS for delays while the meter continues to run for the defendant.

Because of the time and financial constraints, the IRS is in an excellent position to coerce a defendant to settle for the values assigned by the IRS Panel, or to reach a compromise assigned by the court.

In one recent example in Boston for a gem case, the defendant maintained he had paid $10,000 for an unusual green garnet. The tax court judge urged the two parties to find a common ground they could settle their differences by negotiation, with the IRS discussing removing criminal charges and taking off penalties. The defendant said he would take his case to the circuit court, while IRS staff allegedly promised to take the case to the newspapers. At that point, the defendant had already spent $7,000 for the appraisal and expert witness fees.

Discretion being the better part of valor, and financial resources not being without limits, he gave up.

In its equation, the panel and the tax court had not reached a consensus on whether there is a distinct dollar value to something that is unique because of its rarity and artistic potential.

Instead of automatically hauling everyone who is over or under the values assigned by the IRS Panel, let the Treasury Department consider arbitration.

On the one hand, anyone who wished to donate an item to a

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non-profit institution could submit the necessary photographs and supporting data to a professional panel, including those familiar with fair market value. The prospective donor could make an appointment with such panels --- on a regional basis --- and bring the actual item. The U.S. Customs Office already follows such a procedure on imports. This Customs panel resolves differences of opinion on value right at the warehouse, before the merchandise goes out.

This would curtail the practice of inundating the IRS with donations before the end of the year.

Similarly, a gift in law requires a delivery and an acceptance. A museum or other similar institution would have to offer evidence of interest, so it does not merely become of dumping ground for donations. It would eliminate the practice of gifts being delivered in December and accepted in January, involving 2 different tax years.

Wher staff of the IRS Art Advisory unit have questions or disputes concerning submissions and authenticity, ownership, condition of the work and other factors which might arise after the sale or gift of a specific art work, these areas could be mediated by arbitration, rather than only by the courts --- which decide only guilt or innocence. It would appear to be far less adversarial and costly than going to court.

(The Ways and Means Subcommittee may also wish to consult with the American Arbitration Association on the feasibility of such a suggestion. That organization has offices in 26 major cities, with more than 60,000 persons serving as impartial arbitrators. It handled 40,000 cases in 1984. A similar independent board may be more realistic than the current concept of the Art Advisory Panel.)

A second option may be to use something akin to the Federal Trade Commission guidelines. Under this system, experts for both sides of an issue are able to cross examine each other before an administrative law judge.

COMMENTS ON THE IRS ART VALUATION SECTION

The staff of the IRS Art Valuation Section reviews the materials submitted for donation under the tax system and decides which will be discussed by the IRS Art Advisory Panel. This office is charged with reviewing items with a claimed value of $20,000 or more.

With 4 to 5 permanent staffers, this office is underfunded and overworked, which is not unique to this or any other federal agency during this era of budget restraints caused by the ballooning of the defense budget and the deficit.

It will be physically impossible for so few people to review the amount of material that will fall under the auspices of the new appraisal law. If the average item reviewed in the past by this section for overvaluation was $168,000, obviously they are not going to have the time or personnel to go all the way down to $500 donations, as cited in the law.

Another major stumbling block is the ostrich-like mentality of the Office of Management and Budget when it comes to resources for the IRS. Statistically, it has been shown that the IRS generates $100.00 for every 48¢ that it spends to collect monies owed to the government.

However, the OMB has been reluctant to grant a simple request for a $12,000 computer for this Valuation unit which would permit them to review national comparable prices from auction markets; it would be an invaluable tool in measuring accuracy in appraisals.

In the past, questions have been raised as to why the Valuation Section had no permanent staff assigned to New York City, which is considered the major U.S. art market, and a world art center. A few occasional trips to NYC each year are not the same as the constant access to market data. Perhaps a West Coast staff member would also be feasible.

Similarly, the GAT Subcommittee received various complaints about the lack of "new blood" and ongoing training for the Valuation Section personnel. One reason would be cost. However, the federal government does have a program called IPA(intergovernmental Personnel Act) which

allows professional workers to rotate through a government agency or agencies as part of a mutually beneficial arrangement.

Perhaps the Valuation staff could benefit from such an influx of professional employees from auction houses such as Sotheby's or Christie's, as well as public appraisers, museum experts and academics who work in areas dealing with artistic properties and/or aftifacts. Such employees would serve for a fixed period, with compensation paid by their employer, who grants them a temporary leave of absence.

The IRS rarely takes overvaluation or undervaluation cases reviewed by the Advisory Panel to trial, with tax court a more likely step. However, litigation should be fully utilized by this Valuation Section when it is deemed necessary. Perhaps umder the new malpractice standards(Oct. 17, 1985 regulations --- 31 CFR Part 10), the staff and Panel will now urge such action.

In the field, there is a need for better communication and cooperation and training on a local and regional level so that materials could be reviewed for clerical data(ach as forms 8282 and 8283 as well as preliminary assessment of the attached appraisal data) so that the national office in Washington is not overwhelmed by paper. Training in real estate appraising alone is not a suitable substitute for knowledge of art and artifacts.

Professor William Speiller, a law professor at Rutgers University and an expert in the area of the arts and taxes, testified before the GAT Subcommittee on Aug. 4, 1983, that one of the shortcomings of this Valuation Section was that it:

> "...does not try to judge aesthetic value; rather, it studies data on sales of comparable works, makes adjustments on the basis of its research and, if necessary, seeks the informal opinions of those dealing in the objects." ("Revision of IRS Tax Deductions for the Arts," 98th Congress, First Session, Government Operations Committee, p.301)

In contrast with the small IRS Valuation staff, Speiller notes that the NYC office of Sotheby's has 70 appraisal experts. "These individuals are trained at the auction houses, giving them valuable exposure to a huge variety of works and an intimate understanding of the sales prices items will bring. Thus, the appraisals rendered by Sotheby's can and do take into account the aesthetic value of the objects. They are true appraisals, unlike the Service's evaluations, which are merely checks on the basis of its research and the occasional advice of others."(Aug. 4 transcript, p.302)

Given the limitations the Valuation Service works under, it is often ill-equipped to provide aesthetic judgment and wisely refrains from doing so. However, this can be a handicap for the Panel and for the donor since if aesthetic value is not part of the appraisal equation as to the uniqueness of an item, its true worth may not accurately be stated.

OBSERVATIONS ON THE IRS ART ADVISORY PANEL

During the joint IRS/Treasury hearing held on June 29, 1985, one target of the meeting was the IRS Art Advisory Panel and some suggested reforms. In his remarks, Rick D'Avino, attorney/Adviser for Treasury, noted the sliding fee scale employed by the Art Dealers Association of American, which has a large, ongoing representation on the IRS Panel. For some reason, there is an appearance of "sweetheart" legislation regarding ADAA, which was included in the Senate draft based on support from the President's Committee on the Arts and the Humanities.

According to Conference Report 98-861:

> Appraisals for which the fee is based on a percentage of the appraised value cannot qualify. However, appraisals are not disqualified where all or a portion of the fee is based on a sliding scale if a portion of the fee based on a sliding scale is paid to a generally recognized association which regulates appraisers. This exception applies only if no persons have a beneficial interest in the association. (p. 996)

For reasons that are not clear, only the ADAA appears able to utilize this exception. However, the ADAA is composed of art dealers rather than strictly art appraisers, as cited in the legislation, so the law should be rewritten so that it is applicable to all.

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At this same June 1985 hearing, Robert Bley, executive assistant to the director of legislation and regulations, division of the IRS Office of the General Counsel, interjected that:

"We have no influence on the Art Advisory Panel and we're not involved in its composition."

That is not accurate since the Art Advisory Panel was specifically created by the Treasury and the IRS and remains under their auspices. Thus, any changes in its operations remain within their purview.

As Bley notes:

"Our goal is to study the regulations and see if we can't improve them a little bit."

One charge that has been leveled against this panel is cronyism. Indeed, the museum and art worlds form a small, tight circle. On the other hand, those having the expertise to appraise the worth of artifacts are not great in numbers. While a certain degree of "clubiness" is unavoidable, it does seem that a broader scope of individuals could be included -- without breaching either quality of membership or federal conflict-of-interest rules. No one should serve on these panels for an indefinite period of time.

To augment the Valuation staff, it would be helpful to consider similar panels for donated objects such as folk art, coins, stamps and jewelry in a finished state. I am not totally convinced that a similar panel would not also be feasible for gems and minerals, provided a better quality of data was provided to the panel than is now offered.

The power of this panel cannot be underestimated since its opinions generally are followed by the IRS in its negotiations with donors.

> "The Panel has been credited with making an important contribution toward stopping overvaluation of large gifts. This may be true to some extent, but since the Panel sees only a minute fraction of the total gifts of art objects to charity, it hardly affords a complete solution to the overall valuation problem. On the other hand, the Panel has been criticized on conflict-of-interest grounds, because the members are also dealers and museum professionals interested in establishing high prices. In response to this criticism, the Chief of the Service's Art Valuation Group [in 1980], who acts as Chairman of the Panel, has remarked that 'in a perfect world, we would get appraisals from people who were both knowledgeable and isolated. I don't know how to find these people."
> ("Revision of IRS Tax Deductions for the Arts," Hearing Before the Government Operations Committee, 98th Congress, First Session, Aug. 4, 1983, p. 302 -- Prof. Wm. Speiller)

Like all federal agencies, task forces and special units, the Art Advisory Panel should be viewed as something with a "sunset" provision and not a permanent institution. It has evolved a great deal since its inception in 1968, but it may no longer be adequate under the new tax legislation. For more efficiency, it may be time to revise and overhaul its guidelines and to also reconsider whether such functions could be performed internally. I commend the Ways and Means Oversight Subcommittee for taking this time for such a review, rather than automatically rubberstamping a status quo maintenance option.

CONFLICTING DEFINITIONS OF "FAIR MARKET VALUE"

The IRS currently defines the "fair market value" of property as:

"the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of relevant facts." /Sec.1.170A-1(c)(2)/ This definition is included in the 1982 regulations.

Unfortunately, it is not as complete as the definition applicable to Federal estate and gift taxes/Treas. Reg. sec. 20.2031-1(b) and sec. 25.2512-1(1965)./which note that a fair market price is not determined by a forced sale price, nor by a market other than that "in which the item is most commonly sold to the public, taking into account

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the location and condition of the item whenever possible. Thus, an item from a decedent's estate which is new, unused and newly purchased should be valued at the retail cost at the time of valuation. Older used items should be valued at the retail cost in an efficient and relevant market in which such items are most commonly sold to the public, and not at a dealer's cost, nor at liquidation prices." ["Valuation Theory: Fair-Market Value and the Tax Court," Dr. D.B. Michaels, presentation before the Convention of the Southeastern Regional of the American Business Law Association, Oct. 31, to Nov. 1, 1985, Charleston, S.C.]

When the Valuation Section and the IRS Art Advisory Panel review appraisals, they are caught in the conflict of vague definitions for fair market value, as applied to art and aftifacts.

And when the IRS sends these disputes into court, the government is often no more specific in the fair market definition than the defendant.

One glaring example is the case of Anselmo v. Commissioner [80 T.C. 46 (1983)] which involved the donation of 461 gemstones by the Anselmos to the Smithsonian Institution, with the IRS disallowing the deduction and the court asked to resolve the true fair market value of the donation.

The court admonished the expert witness appraisers on both sides[Elly Rosen and Donald Palmieri on behalf of the IRS and Dr. Joel Arem and Sarabeth Koethe for the Anselmos]:

> "What we have in this case are two sets of valuations, each of which is based upon a substantially incorrect view of how the property at issue should be valued. In some cases in which experts' valuations are based on incorrect assumptions it may be possible for the Court to construct reliable estimates of fair market value by adjusting for discredited assumptions. However, this is not such a case."(11th Cir. 1985)

How can the IRS Art Advisory Panel or the IRS Valuation Section decide the accuracy of an appraisal with such a gap in the meaning of fair market value among so-called experts, since fair market value is a component of an item's intrinsic value?

> Dr. Michaels concluded that:
> "...the conflicting 'expert testimony' of appraisers for the Government and the Petitioners turned the judicial process into a veritable courtroom fiasco...The result of this travesty was public embarassment to the Internal Revenue Service, the Smithsonian Instituton; immense and unnecessary expense to the taxpayers; and a devestating blemish on the credibility of responsible gemologists and jewelry appraisers."

THE IRS PANEL AND DONORS WHO ALSO CREATE ART WORKS

One final problem on this long list is how to treat creators of art objects who also wish to be donors for tax purposes so that their contributions would be reviewed by the IRS Art Advisory Panel, just like any other donor.

In 1969, the government repealed the deduction artists had previously received for donating original works to non-profit institutions. Congressional action was taken because President Nixon had decided to give some of his personal papers to a museum and took excessive and unsubstantiated tax donations.

Under the 1984 Tax Reform, all donors are required to simply receive an appraisal from a "qualified" appraiser and to follow the necessary paperwork steps. It would seem realistic to treat creators as donors. Necessary caveats would include a proven track record of sales and achievements for the artist so "junk" would not be donated at public expense. I commend to the attention of the Ways and Means Oversight Subcommittee the proposals submitted by Rep. Tom Downey, D-NY, chairman of the Congressional Arts Caucus, in H.R. 3087[Federal Register, July 26, 19[illegible]

Prior to 1969, the Library of Congress was receiving 200,000 annual, original manuscripts. After the legislation, there has been only or

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major gift of self-created material in 17 years. Truly worthwhile objects will be lost to the public view until this imbalance in the law is corrected.

LEGISLATIVE ATTEMPTS TO IMPROVE THE APPRAISAL PROCESS

Several steps are occurring at the national and state levels which should improve the overall appraisal performance and thus make the jobs of those who serve on the IRS Art Advisory Panel and the Valuation Section easier.

At the National level, the malpractice standards that were finalized on Oct. 17, 1985 will make it easier for the government to prosecute fraudulent appraisers.

In Congress, Rep. Doug Barnard,D-Ga., who chairs the House Commerce, Consumer and Monetary Affairs Subcommittee, held hearings on problems with bank appraisers and introduced H.R. 4956 which calls for disciplinary action against those found guilty of nonprofessional and/or inept conduct in appraisals. The accompanying report by Hal Lippman, who has been loaned to the subcommittee by the General Accounting Office, will detail suggestions on a national certification process for appraisers, which could be broadened beyond the confines of the banking area.

Another national effort is contained in the Uniform Relocation Assistance and Real Property Acquisition, with final regulations issued on March 5, 1985[Federal Register, Vol. 50, No. 43, March 5, 1985, p.8953-8988] These guidelines set forth uniform appraisal policies for 17 federal agencies, although the IRS and Treasury are conspicuously absent in this effort to provide a degree of federal consistency in appraisal policies. (The agencies include the Departments of Agriculture, Energy,Transp Commerce, Housing and Urban Development, Labor, Defense, Education, Interior, Justice, Health and Human Services; TVA; FEMA; GSA, VA, EPA, Pennsylvania Avenue Development Corp.) Each agency has its own prerogatives so the guidelines are tailored to their specific needs. While the emphasis is on personal property appraisals, these joint initiatives also apply to real property.

For future use, in order to insure that the public is being protected from fraudulent appraisers, the IRS may wish to turn to a model developed by the Department of Education that could be adapted for IRS use. The Education Department was trying to decide whether or not it should accredit educational institutions. The Secretary finally devised recognition procedures for independent national accrediting bodies and state agencies which would, in turn,determine on a local or regional basis whether an educational institution met the prescribed standards, and thus was eligible for federal financial assistance.

In applying this concept to appraisers, some form of accreditation would allow the practictioner to submit appraisals to government agencies such as the IRS or Treasury as regards charitable contributions and/or estate and gift tax appraisals. Such accreditation or certification could be supervised by the IRS Director of Practice office and only those holding such a document could have appraisals appear on tax donations and gifts. [See transcript of June 28, 1985 IRS/Treasury hearing, p.5-7]

Turning to State legislation, the Ways and Means Oversight Subcommittee may find of interest some of the initiatives enacted by the New York and California State Legislatures to curtail art appraisal scams as well as consumer protection laws in Maryland, Illinois and Hawaii. I do not know the current status of legislation considered in Texas to certify those who assessed and appraised property for taxation purposes. I also understand that Pennsylvania may be considering some form of licensing for appraisers, but I have no further details.

The more specific the state and national laws regarding appraisers and appraisals become, the fewer fraudulent cases the IRS Art Advisory Panel will have to handle.

RECOMMENDATIONS

In conclusion, let me emphasize that the IRS Art Advisory Panel does not exist in a void, totally separate from the world of appraisers --- since that is the very reason for the existence of this panel. It is time for more than mere cosmetic changes, with a probing look at the initial reason for creating the panel and whether that purpose may now be met in better ways.

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RECOMMENDATIONS:

A. Appraisers

1. Finalize the preliminary regulations issued on Dec. 31, 1984, as soon as possible, taking into account comments received for the record and statements from the June 29, 1984 and June 28, 1985 hearings.

2. Clarify what constitutes a "qualified" appraiser and what constitutes a fraudulent appraiser.

3. Review Section 31 of the Tax Code to consider inclusion of disciplinary action to be taken against fraudulent or incompetent appraisers, similar to those steps now taken against lawyers, accountants and actuaries.

B. Tax Court

1. Consider alternatives to disagreements with valuations set by the Art Advisory Panel, such as arbitration or better administrative procedures such as those used by the Federal Trade Commission of the Customs Service.

2. Minimize the adversarial attitude on the part of the IRS in favor of better information from the donor and greater cooperation by both parties to amicably and efficiently resolve their differences.

C. The Art Valuation Section

1. Improve the training and input from those in the field to those in the national office.

2. Provide an adequate level of equipment, funding and personnel so that the unit can cope with the expected avalanche of work that will be generated by the new appraisal provisions of the tax code.

3. Consider the use of apprenticeships, internships and IPA exchanges to expand and revitalize this office. Recruitment from New York auction houses also should not be ignored in order to get the necessary in-house expertise.

4. Make greater use of litigations process, when it is warranted. As noted by Prof. Wm. Speiller, "The Service rarely takes art valuation cases to court. Although it is in constant disagreement with taxpayers in these cases, it ofen compromises or gives up at some point during the administrative process. Consequently...there are less than two dozen cases reported in the literature."[Testimony from Aug. 4, 1983 hearing, p.304]

D. IRS Art Advisory Panel

1. Encourage broader scope of participation and retain limited term in order to avoid allegations of cronyism or an "old boy" network.

2. Bar members from advertising their ties to this panel while they are currently serving on it. Later, there should be no indication in their ads that a client could expect favorable treatment from the IRS because of their previous affiliation with this panel.

3. Consider possible expandion of the panel concept to other specialities in the art and artifacts areas, i.e. folk art, furniture, rare books and manuscripts; coins and stamps etc.

4. In line with other federal appointments to advisory panels, qualified women and minorities should be appointed to these panels on a regular basis.

E. Definition of Fair Market Value

Seek a better comprehensive definition for "fair market value" for use for contributions, estate taxes/gifts that will be useful to donors, appraisers, the government and the IRS Art Advisory Panel and Valuation unit. It is now a confusing term.

F. Consideration of Creators of Art materials as Donors

Review proposed legislation suggested by Rep. Thomas Downey in H.R. 3087 so that the same rules applicable to all other donors could be followed by creators of these art works for their charitable contributions, with some additional constraints added. Why should they have the work taxed at full value at their death, and no contributed value while they are still alive?

G. Malina, Inc.

ORIENTAL ART

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July 9, 1986

Joseph K. Dowley
Chief Council
Committee on Ways and Means
U. S. House of Representatives
Room 1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Dowley,

I begin this statement with excerpts from a speech made by the capable member of Congress, Rep. Cardis Collins (D. Ill.) Chairwoman of the House Government Activities and Transportation Subcommittee, given on May 18, 1985 before the National Conference of the Appraisers Association of America in New York, N. Y.

Rep.Cardis Collins:

> "I thought of the countless discussions our office has had over the past 20 months with officials from the Treasury and the IRS on what constitutes a "qualified appraiser"-and yet these same officials seem oblivious of the readily apparent answers.
>
> One wonders if these same financial experts-who met with representatives from various appraisal organizations on June 29, 1984, and have had extensive correspondence from them throughout the past year- are like the two monkeys who see no evil and hear no evil. Would these same Treasury and IRS officials have the gall to appear before a meeting of the AMA and ask,"Is there a doctor in the house?"
>
> Yet they fail to see the same lapse of logic when they meet with reputable appraisers who offer them sound advise and conculde:
>
> > "There were no general qualifications we could give," according to Beverly Baughman, the IRS attorney who drafted the inadequate appraisal regulations which adamently refuse to set any minimum criteria.
>
> If you think you are frustated by this lack of candor and clarity by both the IRS and the Treasury, you are not alone!
>
> We are still in the dark on what constitutes a qualified appraiser or how anyone will be able to find one, based on the deliberately vague wording of these regulations.
>
> While the talk within Administration circles these past four years has been to rid the public of any so-called "interference" and burdensome red-tape", what has actually happened is that the public protections, which once the Federal Government so willingly extended to all its citizens, has been lost."

At this same National Conference of the Appraisers Association of America-the following day-May 19, 1985 there was another guest speaking: a Mr. Peter Marks who apparently belongs to a group called

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American Association of Dealers in Ancient, Oriental, and Primative Art. (see enclosed form of this organization). Mr. Marks, in his conversation mentioned that his group had had some problems with the IRS some time in the past but after expenses of $400,000. to $500,000. (possibly legal fees ?? or ??) there have been no problems. He also stated that the IRS dealt differantly with their appraisals and didn't bother to attempt to use any auction prices as a guide when studying their appraisals. (in most instances auction prices are the only valuations the IRS or the Art Advisory Panel used to challenge any appraisal.)

He also stated that his organization did their appraisals by use of photographs.

Please also note that the American Association of Dealers in Ancient, Oriental, and Primitive Art, is an anonymous "groupie" appraisal, with no individual appraiser having to sign or be held responsible to the valuation.

Now- consider the recent IRS rulings concerning penalties, fees, etc. regarding individual appraisers, but not applying to groups such as the American Association of Dealers in Ancient, Oriental, and Primitive Art- or the others that operate as anonymous "groupies".

I also think it very important to also state that Mr. Joseph E. Bothwell of the IRS has distributed to museums the enclosed form of the American Association of Dealers in Ancient, Oriental, and Primitive Art, with the suggestion that they use this group for appraisals. I believe Mr. Bothwell is in charge of the Art Advisory Panel which handles Far Eastern and Asian Art.

With regard to the Art Advisory Panel (Far Eastern and Asian Art) it consists of Mr. Henry Trubner, Associate Director, Seattle Art Museum
Dr. Pratapaditya Pal, Los Angeles County Museum
Dr. Thomas Lawton, Director, Freer Gallery of Art
Dr. Sherman E. Lee, formerly Director of the Cleveland Museum, currently Adjunct Professor, University of North Carolina
Mr. Robert Ellsworth, R.H. Ellswoth, Inc., N.Y.,N.Y.

Please take special note that there is no qualified appraiser on this panel.

The first four names listed on the Art Advisory Panel (Far Eastern and Asian Art) are all from the academic museum section, and one of the rules of Museums is that they are not to be involved with valuations, only with authenticity. In addition, when the panel meets, they are giving opinions almost always, from photographs. This in itself is a very sensitive No No for a competent museum scholar.

Neither authentication or valuation can honestly be done without actually seeing and examining the item.

Mr. Robert Ellswoth, the fifth member of this panel does not belong to any recognized self policing appraisal organization, but is merely a dealer, selling merchandise.

G. Malina, Inc.

ORIENTAL ART

680 MADISON AVENUE
NEW YORK, N.Y. 10021
(212) 903-4890

When the five members were placed on the Art Advisory Panel (Far Eastern and Asian Art) it was for a specific length of time. Their term on this panel expired as of December 31, 1985; yet they are still on the panel and no new panel has been appointed to replace them.

In its Art Advisory Panel Hearing, and other IRS Hearings, the committee should return to "square one", and really and honestly simplify things.

First- We have thousands of fine art scholars studying and working in museums and schools throughout this country. It is their life, their work. They are quite capable of studying, physically handling, and authenticating artworks. When faced with a problem item they discuss it woth others in their field. Why then should their capabilities by negated. Does it really make any honest sense to allow a small group sitting for a few hours with hundreds of photographs, to negate all the thousands of art scholars, researchers, curators, etc. in our country ???

The Art Advisory Panel has made numerous mistakes, and this information should be in the files of Rep. Cardiss Collins.

Second- For a number of years there have been two fine self policing appraisers organizations, the Appraisers Association of America, and the American Society of Appraisers.

As Representative Cardiss Collins, the Chairwoman of a Congressional Committee has found out, the IRS which is under the Executive branch of our government, still has to supply the answer to her question of what constitutes a "qualified appraiser".

When you have two fine organizations of proffessional appraisers in existance, why is the IRS so consistant in its refusal to accept them as proffessionals, and instead keeps throwing "roadblocks" in their way ?(study the recent IRS penalties, etc., regarding appraisers- but which do not apply to appraisals by organized "groupies".)

Third- Is there really any need for the IRS to have any Art Advisory Panels ? Please give some thought to this question- very deep thought. Wouldn't control of the Art Advisory Panel be the "key" element to control the Art marketplace....control what museums, institutions, and corporations purchase, or aquire from others. Remember the art market is involved with very substantial sums of money.

I imagine that the IRS Art Advisory Panel has probably informed the committee that it has been reevaluating artworks and made people pay additional sums to the government. If this is so, they may have neglected to tell the committee that most individuals react to the IRS as they would to the KGB- with fear. They may have also neglected to point to the committee that the way the law is structured, to avoid penalties and interest-people have paid. However, in the coming years many of these people will probably be filing numerous countersuits.

Yours truly,

Gerald Malina

G. Malina, Inc.

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680 MADISON AVENUE
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(212) 903-4890

P.S. At the National Conference of the Appraisers Association of America in New York City on May 18, 1985, I spoke with Leslie S. Shapiro, Director of Practice, IRS, after his speech. We talked about appraising or authenticating from only a photograph. He mentioned that he had walked into a room where the Art Advisory Panel was passing around photographs, and he felt a little quizical about this method.

cc: Rep. Cardis Collins
cc: Rep. Al McCandless
cc: Rep. Doug Barnard, Jr.
cc: Rep. Jack Brooks
cc: Leslie S. Shapiro, IRS Director of Practice

ATTACHMENT TO G. MALINA, INC., LETTER

American Association of Dealers in Ancient, Oriental, and Primitive Art

As a service to donors, museums and other institutions gifts to which are exempt from Federal income taxes, the American Association of Dealers in Ancient, Oriental and Primitive Art will provide its opinion of the financial value of an object whose origin places it within the Association's field of knowledge. Such appraisals are made by a panel of up to five members of the Association, and other experts as may be required; the appraisal itself is rendered on behalf of the Association.

Each request for appraisal must be accompanied by three eight by ten inch photographs, unless another form of photographic reproduction is more appropriate. An appraisal by the Association presumes the genuineness of the object to be appraised, but is by no means a certificate of authenticity. The Association will not become involved in questions of attribution except in those cases where the value of an object would be substantially altered by such attribution; in such cases the appraisal will express an opinion and should not be considered as a statement of fact.

The accompanying documents should be read carefully, completed where appropriate and returned to the Association.

c/o Douglas C. Ewing, President, 1185 Park Avenue, New York, NY 10028

CONDITIONS OF APPRAISAL

Appraisals made by the American Association of Dealers in Ancient, Oriental and Primitive Art are made subject to the following conditions:

1. The appraisal is for an object already given or committed for donation to a museum, university or similar institution gifts to which are recognized by the Internal Revenue Service as exempt for income tax purposes.

2. The appraisal constitutes the Association's judicious opinion of the present fair market value of the gift.

3. The appraisal expresses the opinion of the Association that the object(s) in question is (are) genuine, but does not constitute a certificate of authenticity.

4. The Association reserves the right to refuse to make an appraisal for any object, either because of questions of its authenticity or because insufficient evidence of its fair market value is available. Such a refusal would be made without prejudice.

5. The appraisal will be made by the Association, which shall draw its opinion from a panel of its members or from such outside experts as may be required. The names of those people involved in the appraisal shall be confidential.

6. The name of the donor shall be kept in confidence by the Association and shall not be provided to the panel of appraisers.

7. The signature of the donor on the Letter of Agreement constitutes his agreement to the above terms and conditions, as well as his agreement to pay the appraisal fee to the Association within thirty days of receipt of the appraisal. The donor's signature also releases the Association, its officers, directors, members, employees, agents or consultants from any and all liability of any kind whatever arising from, or connected to, the requested appraisal.

INFORMATION FOR APPRAISAL

Name of Donor .....

Address .....

City and State .....

Name of Recipient .....

Address .....

City and State .....

DESCRIPTION OF OBJECT

Type of Object .....

Country or Region of Origin .....

Approximate Date .....

Material (s) .....

Dimensions H.....W.....D.....(inches)

Condition .....

Provenance, including Dealers .....

Notes of Publication and Exhibition .....

Additional Information .....

LETTER OF AGREEMENT

The American Association of Dealers in Ancient,
Oriental and Primitive Art
c/o Douglas C. Ewing, President
159 1/2 East 94 th Street
New York, New York 10028

Dear Sirs:

I hereby request your Association to appraise the objects which are described on the accompanying documents and of which I enclose photographs. I have read the "Conditions of Appraisal" and this letter constitutes my agreement to those terms.

I will pay to the Association a fee for its services, as determined by the following schedule:

Appraised Value per Object	Fee
Up to $3,000.00	$75.00
$3,001.00 to $6,499.00	$125.00
$6,500.00 to $9,499.00	$175.00
$9,500.00 to $12,499.00	$250.00
$12,500.00 to $24, 999.00	$350.00
$25,000.00 to $49, 999.00	$450.00
$50,000.00 to $74, 999.00	$600.00
$75,000.00 to $99, 999.00	$750.00
$100,000.00 and over	1 % up to $300,000.00 1/2 of 1% on any amount between $300,001.00 and $1,000,000.00; a flat rate of $5,000.00 above $1,000,000.00.

Signed .....

Date .....

June 2, 1986

Subcommittee on Oversight
Committee on Ways and Means
United States House of Representatives
1101 Longworth House Office Building
Washington, D.C. 20515

Written statement submitted by:

R. Crosby Kemper, Chairman, United Missouri Bancshares, Inc.,
P.O. Box 1771, Kansas City, MO 64141, (816) 556-7311

RE: Hearing to Review the Internal Revenue Service's Art Advisory Panel

I am sorry I cannot be there to testify in person, but I hope this letter will give you some insight as to how a donor to a museum feels about his personal collection and gifts.

I have a fairly extensive personal art collection and, from time to time, I have given objects to museums in this part of the country. I shall not give another gift to museums out of my own collection as I feel I have been penalized by the Internal Revenue Service to a good extent when I have done such a thing.

A few years ago I gave one of the best examples of Frederic Remington's "Bronco Buster" to the Nelson-Atkins Museum in Kansas City, Missouri. It was appraised by Richard Wunder of Christie's in New York, at $100,000.00. After several years of arguments with the Internal Revenue Service, we had a compromise of $55,000.00. I feel certain I could have sold it on the open market for much more.

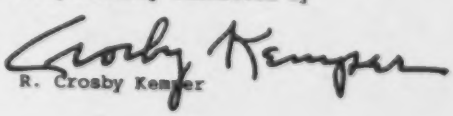
I also gave a large black and white water color by Remington of some very good subjects, which was appraised by Richard Wunder at $25,000.00, and the Internal Revenue Service allowed me only $15,000.00.

I have another example of giving a very fine George Caleb Bingham hand-tinted lithograph of "The Jolly Flat Boatmen" to the Albrecht Gallery in St. Joseph, Missouri. It was appraised by Norman Hirschl of Hirschl & Adler Galleries, New York, at $25,000.00, and the Internal Revenue Service only allowed $2,500.00. Our own State Department in Washington, D.C. offered $29,000.00 for a similar one.

In addition, I gave to the Albrecht Gallery an 18th Century antique Aubusson rug, which was appraised by Al Caputo of Patterson, Flynn & Martin, Inc., New York, at a value of $30,000.00. The Internal Revenue Service allowed only $4,500.00.

Because of these conclusions by the Art Advisory Panel of the Internal Revenue Service I had to pay a great amount of interest and penalties to the Internal Revenue during the period this was in question. Since this experience, when I dispose of something from my personal collection, I sell it on the open market and it has been a much more satisfactory thing to do. I certainly understand when somebody tries to take advantage of the situation and appraise up something that is virtually worthless. However, when you are talking about Frederic Remington and George Caleb Bingham, there should be some experts on the Panel that respect solid appraisals from first-class people who know about Western art. Perhaps, the panel is composed of easterners who understand nothing but the abstract and are not familiar with art west of the Mississippi.

Respectfully submitted by



R. Crosby Kemper

July 17, 1986

Joseph K. Dowley
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
Room 1102
Longworth House Office Building
Washington, D.C. 20515

CONCERNING THE REVIEW OF THE INTERNAL REVENUE SERVICE'S ART ADVISORY PANEL:

It would appear from Press Release #21 of the Subcommittee on Oversight, Committee on Ways and Means, U.S House of Representatives, that attention is being focused on over or undervaluation of art objects as the subject pertains to offending the Federal Government. In this announcement of the Committee's review of the IRS's Art Advisory Panel, no reference is made to the other side of the coin: the serious flaws in the evaluation system with resulting negative effects on the taxpayer/donor, and it is to this issue that I address my comments.

The present system, unless it is substantially revised and/or reinforced, will ultimately discourage contributions by private citizens, thereby drying up sources of major acquisitions for our museums and communities. This is not to say the Panel system is all bad - on the contrary, it's fine as far as it goes.

My statement will be in an anecdotal format so as to be more interesting, but the identity of everyone and every quotation will be substantiated upon request from the Committee. My reason for not submitting the names of all the players is that I'm not sure it's relevant and I do not intend to denigrate the system or any individuals connected with it.

As I understand it, the Art Advisory Panel consists of 12 art oriented people such as dealers and curators who serve without pay and who meet in Washington, D.C. a couple of days a year to pass on valuation reports submitted by the Chief of the IRS's Art Valuation Section of the Appeals Division, and staff. The reports are based largely on statistical information gathered from lists of public sales published by auction houses. The Panel reviews approximately 300 items of art during each of its one-day meetings and places values on these items "by consensus". Any panel member who may have dealt in any particular item or who might otherwise have some conflict of interest, is excused from the meeting during the time the item in question is being considered. While this may eliminate conflict of interest, it follows that it may also eliminate from the proceedings, the most expert and knowledgeable person on that particular object.

In one case with which I am familiar, the Art Advisory Panel passed on the valuation of certain works of art twice - originally during the audit of a 1977 return and again in response to the Protest filed. The Panel did not change its original values in the Reconsideration it submitted. In neither instance did the Panel or the IRS staff see the works of art involved. In this case, the IRS witness testified as to the high quality of the objects, but continued to use only statistical information and refused to consider private sales information that was available. In their "research" they saw only black and white photographs and a few color slides. The Panel's report in each case was based solely on statistical information accumulated from publications documenting public auction prices. Its reports contained no reference to private sales or private asking prices. No consideration was given to the quality of the art identified in the reports in relationship to the quality of the works involved. Never was the condition of the works taken into account. Further, not one member of the Panel could qualify as an expert in this artist's work.

In the witness's Report, the same statistical approach was followed in preparing the Art Advisory Panel reports. The witness had not seen the Petitioner's works of art when the report was prepared. The witness never saw these works until two days before the trial. By her own testimony she admitted that certain of the Petitioner's works were of "fine quality" and "very good". Moreover, she admitted she was not an expert in the particular field involved, rather she was a general appraiser. In fact, she could not remember ever having seen a painting

by this artist before and therefore, had no real yardstick by which to make comparisons.

She further misstated (under oath) that this artist's works are held by "only six museums in the world," when in fact, more than a dozen own them. There isn't the slightest doubt the witness believed what she said to be true, but it was false, nevertheless. It wouldn't have taken a great deal of preparation on her part to have had more accurate information. Disregarding the best intentions, this was tantamount (albeit unconsciously) to giving a frivolous report in a matter that might, and probably will, cost the taxpayer a substantial amount of money. I submit her lack of preparation was due to being spread too thin in addition to the fact that no one can be expert in everything.

The use of auction sales prices, without other reinforcement, to determine fair market value, often leads to astonishing distortions. Take, for example, recent auction activity in the works of the nineteenth century American artist, Rembrandt Peale. A Peale portrait auctioned on December 7, 1984, was estimated in advance by the auction house, Christie's, to sell for between $2 and $4 thousand. Its dimensions were 24-1/8 x 20-1/4 inches. Another Rembrandt Peale portrait auctioned on December 5, 1985, was estimated by the auction house, Sotheby's in this instance, to sell for between $3 and $4 million. It's dimensions were 28 x 34 inches. The disparity in these estimates for paintings by the same artist, of roughly the same size and to be sold at approximately the same time is explained by reference to the paintings' quality. The Sotheby's Peale was vastly superior in quality to the Christie's Peale and was also of historial significance. Admittedly, this is a particularly dramatic example, but not as exaggerated as the "art history slide show," given for the benefit of the Oversight Subcommittee, in which a $550 African fertility figure was inflated to $950,000. In this case, at least one expert erred in assessing the value (and probably more than one).

Recourse to auction prices as comparables may lead to still more distortion. When a dealer buys at auction he will often double the purchase price when the object goes into his inventory since he doesn't know how long he'll keep it. If it sells privately within one year of its purchase, a significant profit may be realized. On the other hand, if it takes 10 or 15 years to resell it, no significant profit is realized given the cost of money and carrying charges. Thus, when an auction price is used, further inquiry must be made as to the ultimate disposition of the object. If it sold soon after for twice its auction price, the auction price is not a good standard of value. If it is held for a long period of time, then the auction price becomes a better (though still inaccurate) indicator of value depending on how and when it sold (maybe it went back to auction) and for how much.

Other problems arise in the use of auction sales prices in evaluating the works of important artists whose paintings are seldom traded. In such cases, since there is little activity, the major works will almost always sell privately through a dealer or among individuals for relatively high prices because of the rarity of the objects. Inferior objects will find their way to auction with resulting low prices.

Although determining the fair market value of an art object is an inexact science at best, the "guesstimates" can be informed and intelligent. Basic among the necessary tools are comparable sales - public and private. The matter of comparability, though, must reach beyond issues of size and dates of sales. Critical and essential here are the overriding issues of quality and condition. As mentioned earlier, the question that must always be asked is whether the comparables being used are at the same level of quality and condition as the works being valued. As regards condition, let me give an example: A number of years ago a major northeastern museum of which I am a Life Trustee was offered a Rembrandt portrait (for $1 million) by a prestigious New York gallery. A large color transparency received indicated the possibility that a major acquisition for our museum was at hand and we had the painting sent in for inspection. It's important to know that in an old master portrait, restoration of background is usually acceptable, but if the face and hands are substantially restored, the value is seriously impaired. When examined under "black light" this Rembrandt turned out to have been heavily restored with so little left of the original Rembrandt, in these features, that the purchase wasn't made. Besides being an interesting story which, by the way, is a fairly typical one, this is graphic illustration of the need for first hand inspection.

Since it is hardly useful to criticise without being constructive, the following suggestions are respectfully submitted as possible solutions, or partial solutions,

to the present evaluation system:

1. There are many experts in the United States whose fields of expertise are fairly esoteric. They come from the non-professional ranks of collectors, patrons and critics, and are often as well, and sometimes better, qualified than professional experts since their field of expertise may be narrower and thus more thorough. A cadre of such experts who would be sworn to the same restrictions and discretion as any other IRS employee, should be identified and asked to participate, "pro bono," on a selective basis, when their services are required. It is my guess that such citizens would be easy to find.

   These experts should then be asked to make a written report on each work examined (to the Panel) which could be simplified by the development of a form for the purpose. This report should not only include opinion as to value, condition and appropriateness of the donor's value, it should indicate what the sources of information are and the report should be notarized or otherwise attested to. Further, one or more experts (either from the Panel or this cadre) should actually see the objects first hand, at the donor's expense, if necessary, and whenever possible where the value claimed is $20,000, or more.

2. The taxpayer should not be penalized for the Panel's lack of knowledge or for challenging the Panel. Too often, such donors are intimidated into an unjust settlement simply because a drawn-out legal proceeding generates substantial legal fees, often accompanied by penalties and interest. There is nothing sacrosanct about a Panel, composed of professionals, dealing in an area where inexactness is the norm, not the exception.

3. More meetings must be held. No committee can do justice to 300 cases in a day even if, as one IRS witness testified, "they work through lunch."

4. Concerning (3) above, it is claimed that members of the Advisory Panel are given "homework" outside of Committee meeting hours. If so, proof of such research should be required through a report form. Busy "pro bono" professionals do, after all, have other overriding responsibilities and may or may not do all possible in behalf of the donor/taxpayer.

5. The analogy used by the Review Section that the work of seldom traded artists "is like having a barn full of buggy whips" (another IRS witness's statement) is ridiculous. Rarely traded art by important artists has a market which can be identified because those specifically interested in any esoteric area of the arts know how to find each other. Come to think of it, I bet there's someone around who would be interested in "a barn full of buggy whips".

6. The "Brownie-point" system for evaluating the performance of the IRS Art Valuation Section has got to stop. IRS professionals, most of whom are competent, are too busy trying to justify themselves in an inadequate system (see attached newsbrief from June 23, 1986, "Insight," for example). Congress always seems impressed by dollars recovered and so government employees too often pander to that fact.

Success shouldn't be measured simply in counting the dollars brought in, but must be viewed for efficiency, correctness and fairness of method. Donor/taxpayers should be encouraged to make contributions but the present cost of challenging the IRS Panel will, instead, discourage the private sector from future philanthropic endeavor.

Attached is a brief resume of the writer's background and credentials. I will be pleased to provide any service, advice or document that may help in dealing with this very sensitive matter.

Thank you for this opportunity to participate in your review.

Respectfully submitted,

James L. Winokur

James L. Winokur